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No. 2989 No. 14095

United States
Court of Appeals
for the Ninth Circuit.

SEABOARD FINANCE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of the Tax Court of the United States.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—12-18-53

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

APPEARANCES

For Petitioner:

DANA LATHAM, ESQ.;

AUSTIN H. PECK, JR., ESQ.;

HENRY C. DIEHL, ESQ.

For Respondent:

R. E. MAIDEN, JR., ESQ.

The Tax Court of the United States

Docket No. 30554

SEABOARD FINANCE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1950

Sept. 15—Petition received and filed. Taxpayer notified. Fee paid.

Sept. 18—Copy of petition served on General Counsel.

Sept. 15—Request for Circuit hearing in Los Angeles, Calif., filed by taxpayer. 10/4/50—Granted.

Nov. 13—Answer filed by respondent.

Nov. 17—Copy of answer served on taxpayer, Los Angeles, Calif.

1952

Feb. 20—Hearing set May 19, 1952, Los Angeles, Calif.

May 23—Hearing had before Judge Opper on merits, respondent's oral motion for leave of 20 days to file amendment to answer granted, petitioner allowed 5 days thereafter to file reply to amended answer.

Stipulation of facts with exhibits filed at hearing. Petitioner's brief, 7/22/52, respondent's 9/5/52, reply—9/22/52.

June 11—Amendment to answer filed by General Counsel. Copy served.

June 15—Transcript of Hearing 5/23/52 filed.

June 19—Motion for leave to file reply to amendment to answer, reply lodged, filed by taxpayer, granted.

June 20—Copies of motion and reply served on General Counsel.

July 21—Brief filed by taxpayer. Copy served.

Sept. 5—Motion to extend time to Oct. 3, 1952, to file brief filed by General Counsel. Granted 9/8/52.

Sept. 29—Motion to extend time to 11/3/52 to file reply brief, filed by taxpayer.

Oct. 3—Motion to extend time to 11/3/52 to file brief filed by General Counsel. 10/6/52—Granted.

Oct. 17—Motion for extension to Dec. 3, 1952, to file reply brief filed by taxpayer. 10/17/52 Granted.

Nov. 3—Motion for extension to Nov. 13, 1952, to file brief, filed by General Counsel. 11/4/52—Granted.

Nov. 13—Answer brief filed by General Counsel. 11/14/52—Copy served.

1953

Nov. 28—Reply brief filed by taxpayer. Copy served.

May 21—Findings of fact and opinion rendered. Judge Opper. Decision will be entered for the respondent. Copy served.

May 21—Decision entered. Judge Opper. Div. 14.

Aug. 21—Petition for review by U. S. Court of Appeals for the Ninth Circuit filed by taxpayer.

Aug. 21—Proof of Service filed.

Sept. 18—Designation of contents of record and statement of points filed by taxpayer, with attached affidavit of service by mail thereon.

Sept. 18—Notice of filing designation of contents of record and statement of points filed by taxpayer.

Sept. 22—Order extending time to 11/19/53 for filing the record and docketing the appeal, entered.

Sept. 24—Counter designation of contents of record filed by General Counsel, with statement of service by mail thereon.

[Title of Tax Court and Cause.]

PETITION

The above-named petitioner hereby petitions for a

redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:LHP), dated June 28, 1950, and as a basis of this proceeding alleges as follows:

I.

Petitioner is a corporation organized and existing under the laws of the State of Delaware, with its principal office located at 945 South Flower Street, Los Angeles 15, California. Petitioner's income tax return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles, California.

II.

The notice of deficiency, a copy of which is attached hereto and marked Exhibit "A," was mailed to petitioner on June 28, 1950.

III.

The deficiency determined by respondent in said notice of deficiency is in federal income tax for the taxable year ended September 30, 1947, in the amount of $70,590.74.

The amount in controversy in this proceeding is approximately $70,590.74.

IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) Respondent erroneously disallowed as a deduction in computing petitioner's net income the amount of $77,298.06, or any other amount, repre-

senting amortization, for the period here involved, of the excess of cost of acquisition of certain assets, consisting in part of stocks of subsidiary companies, over the equity in such net assets at date of acquisition.

(2) Respondent erred in his determination that petitioner realized no gain from conversion of foreign exchange in the Dominion of Canada.

(3) Respondent erred in disallowing as a credit against petitioner's income tax a portion of the income taxes paid by petitioner to the Dominion of Canada and claimed by petitioner as a credit in computing its income tax liability to the United States for the period here involved.

(4) Respondent erred in his determination that the credit for income taxes paid by petitioner to the Dominion of Canada was $153,705.40, or any other amount less than the amount claimed as a credit by petitioner in its income tax return for the period here involved.

V.

The facts upon which petitioner relies as a basis for this proceeding are as follows:

(1) Petitioner is a corporation organized and existing under the laws of the State of Delaware, with its principal office at 945 South Flower Street, Los Angeles, California. Its federal income tax return for the period here involved was filed with the Collector of Internal Revenue for the Sixth District of California at Los Angeles, California.

(2) Prior to the period here involved, petitioner

acquired all, or substantially all, of the outstanding shares of stock of four other corporations, namely: Seaboard Finance Corporation, Par Associates, Inc., National Money Corporation, and Campbell Finance Corporation. The amounts paid by petitioner for said shares exceeded by substantial amounts the net value of the underlying assets of said corporations.

(3) Said four corporations were engaged in the small loan business, and each had outstanding loans receivable for which petitioner was willing to pay, and did pay, a premium. Petitioner desired to purchase said receivables in order to expand its business in amount and in areas in which it had not previously been active. Petitioner was unable to purchase said receivables direct, and could acquire them only through purchase of the shares of stock of said corporations in the manner and for the prices which it did in fact pay.

(4) Substantially all of the assets of said four corporations were loans receivable which had a limited life. Petitioner amortized the excess cost of the assets over a twelve-year period, as required by the Securities and Exchange Commission of the United States. Said loans receivable in fact have a useful life less than twelve years.

(5) On or about March 27, 1946, petitioner purchased 2,200,000 Canadian dollars at Toronto, Ontario, at a cost in United States dollars, at the then existing rate of exchange, of $2,000,000. Said Canadian dollars were held in Canada until on or about December 12, 1946, at which time they were ap-

plied, at petitioner's direction, on the purchase price in Canada of 50,000 shares of stock of Campbell Finance Corporation, a Canadian corporation engaged in the small loan business in Canada. At the time of said application, the value of the Canadian dollar in relation to the United States dollar had increased over its value on March 27, 1946.

(6) By reason of the application of said Canadian dollars as above described, petitioner realized a gain on conversion of foreign exchange in the amount of $189,000, which gain occurred in Canada. Petitioner reported said gain in its income tax return for the period here involved, and took it into account in computing the credit to which it was entitled on account of income taxes paid to the Dominion of Canada.

(7) Respondent eliminated said conversion gain from petitioner's income, thereby reducing the ratio of petitioner's net income from sources outside the United States, to wit: Canada, and correspondingly reduced the credit for income taxes paid by petitioner to the Dominion of Canada.

Wherefore, petitioner prays that this court hear this proceeding and determine that respondent erred in the particulars set forth in paragraph IV above.

Respectfully submitted,

/s/ DANA LATHAM,

/s/ AUSTIN H. PECK, JR.,

/s/ HENRY C. DIEHL,

Counsel for Petitioner.

State of California,
County of Los Angeles—ss.

A. E. Weidman, being first duly sworn, deposes and says: That he is the Secretary of Seaboard Finance Company of California, the petitioner in the foregoing Petition; that he is duly authorized to verify the foregoing Petition; that he has read the foregoing Petition and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon information and/or belief, and as to those matters, that he believes it to be true.

/s/ A. E. WEIDMAN.

Subscribed and sworn to before me this 7th day of Sept., 1950.

[Seal] /s/ ETHA M. DAVISSON,
Notary Public in and for the County of Los Angeles, State of California.

My Commission Expires Feb. 11, 1952.

EXHIBIT A

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles 13, California

Office of
Internal Revenue
Agent in Charge
Los Angeles Division

LA:IT.90D:LHP

June 28, 1950.

Seaboard Finance Company,
945 South Flower Street,
Los Angeles 15, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended September 30, 1947, discloses a deficiency of $70,590.74, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

GEO. J. SCHOENEMAN,
Commissioner.

By /s/ GEORGE D. MARTIN,
Internal Revenue Agent in
Charge

LHP:vmc
Enclosures:
Statement
Form of Waiver

STATEMENT

LA:IT:90D:LHP

Seaboard Finance Company
945 South Flower Street
Los Angeles 15, California

Tax Liability for the Taxable Year
Ended September 30, 1947

	Liability	Assessed	Deficiency
Income tax	$731,660.69	$661,069.95	$70,590.74

In making this determination of your income tax liability careful consideration has been given to the reports of examination dated June 13, 1949, and March 13, 1950, to your protests dated November 26, 1949, and April 17, 1950, and to the statements made at the conferences held.

It has been determined that the correct amount of the credit allowable for taxes paid to a foreign country is $153,705.40, in lieu of $230,580.91, the amount claimed in your return.

A copy of this letter and statement has been mailed to your representative, Mr. Dana Latham, 1112 Title Guarantee Building, 411 West Fifth Street, Los Angeles 13, California, in accordance with the authorization contained in the power of attorney executed by you.

Adjustments to Net Income

Net income as disclosed by return		$ 2,544,962.26
Unallowable deductions:		
(a) Franchise tax decreased	$ 36,607.11	
(b) Amortization disallowed	77,298.06	113,905.17
Total		$ 2,658,867.43
Nontaxable income:		
(c) Long-term capital gain decreased		198,274.93
Net income adjusted		$ 2,460,592.50

Explanation of Adjustments

(a) It has been determined that the correct deduction for California franchise tax is the amount of $50,809.05, in lieu of the amount, $87,416.16, claimed in your return, or a decrease of $36,607.11.

(b) The deduction of $77,298.06 claimed in your return for "Amortization of excess of cost of acquisition of capital stocks of subsidiary companies over equity in net assets thereof as shown by books of subsidiaries at dates of acquisition" is disallowed as not constituting a proper deduction under any section of the Internal Revenue Code.

(c) It has been determined that a long-term capital gain of $416,475.08 was realized from the sale or exchange of capital assets during this taxable year, in lieu of $614,750.01, the amount reported in your return, or a decrease of $198,274.93, which amount is computed as follows:

(1) Conversion gain on deposit eliminated from income	$189,000.00
(2) Gain from sale of stock decreased	9,274.93
Total decrease	$198,274.93

Explanation

(1) In your return you report a long-term capital gain of $189,000.00 designated as "Conversion gain on $2,000,000.00 deposit." It has been determined that no taxable gain resulted in connection with this transaction and the gain reported therefrom is eliminated from your income.

(2) It has been determined that a long-term capital gain of $137,300.31 was realized from the sale of 50,000 shares of stock of Campbell Finance Corporation, Ltd., in lieu of $146,575.24, the amount reported in your return, or a decrease of $9,274.93. The amount of $137,300.31 is computed as follows:

Net sale price, per return	$ 2,126,827.99

Explantion—(Continued)

Basis as determined:		
$2,214,969.94, Canadian converted at $0.9090, exchange rate at date of purchase	$ 2,013,407.68	
Less: Adjustment at date of settlement, $24,000.00, Canadian, converted at $0.995, exchange rate at date of settlement	23,880.00	
Net basis		1,989,527.68
Long-term capital gain, as determined		$ 137,300.31

Computation of Income Tax

Net income adjusted	$ 2,460,592.50
Normal—tax net income	$ 2,460,592.50
Surtax net income	$ 2,460,592.50

Computation under General Rule
(sections 13 and 15, I.R.C.)

Normal tax:		
24% of $2,460,592.50	$ 590,542.20	
Surtax:		
14% of $2,460,592.50	344,482.95	
Total tax under general rule		$ 935,025.15

Computation of Alternative Tax
(section 117(c), I.R.C.)

	Normal-tax Net Income	Surtax Net Income
Income as above	$ 2,460,592.50	$ 2,460,592.50
Less: Excess of net long-term capital gain over net short-term capital loss	381,992.78	381,992.78
Ordinary net income	$ 2,078,599.72	$ 2,078,599.72

Explanation—(Continued)

Normal tax:		
24% of $2,078,599.72	$ 498,863.93	
Surtax:		
14% of $2,078,599.72	291,003.96	
Partial tax		$ 789,867.89
Plus: 25% of $381,992.78		$ 95,498.20
Alternative tax		$ 885,366.09
Less: Credit for income taxes paid to foreign country		153,705.40
Correct income tax liability		$ 731,660.69
Income tax assessed:		
Original, account No. 1-410183		661,069.95
Deficiency of income tax		$ 70,590.74

Received and filed September 15, 1950, T.C.U.S.

Served September 18, 1950.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I. and II.

Admits the allegations contained in paragraphs I and II of the petition.

III.

Admits that the deficiency determined by respondent in the notice of deficiency is in Federal income taxes for the taxable year ended September 30, 1947; but denies the remaining allegations contained in paragraph III of the petition, and all subdivisions thereof.

IV.

(1) to (4), inclusive. Denies the allegations of error contained in subparagraphs (1) to (4), inclusive, of paragraph IV of the petition.

V.

(1) Admits the allegations contained in subparagraph (1) of paragraph V of the petition.

(2) to (5), inclusive. Denies the allegations contained in subparagraphs (2) to (5), inclusive, of paragraph V of the petition.

(6) Admits the allegations contained in the second sentence of subparagraph (6) of paragraph V of the petition; but denies the remaining allegations contained in said subparagraph.

(7) Admits the allegations contained in subparagraph (7) of paragraph V of the petition, except that respondent denies that petitioner realized any taxable gain on the transaction referred to in said subparagraph.

VI.

Denies generally and specifically each and every allegation contained in the petition not hereinabove admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ CHARLES OLIPHANT, E.C.C.
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;

E. C. CROUTER,

R. E. MAIDEN, JR.,

Special Attorneys, Bureau of
Internal Revenue.

Received and filed November 13, 1950, T.C.U.S.

[Title of Tax Court and Cause.]

AMENDMENT TO ANSWER

Comes now the Commissioner of Internal Revenue by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, pursuant to permission granted by the Court on the hearing of the above-entitled proceeding at Los Angeles, California, on May 23, 1952, and amends his answer heretofore filed in this proceeding by adding after paragraph VI, and before the Wherefore clause, the following allegation, copied verbatim, as directed by the Court, from the oral motion to amend made

by counsel for respondent, as it was put down in the official transcript. (Tr. 30, 32).

VII.

"* * * that in the event the facts and the law of this case should require the Court to hold that the acquisition of the Campbell stock did not occur until November or December of 1946, then the Respondent erred in treating the sale of the Campbell stock as a long-term capital gain and should have treated it as a short-term capital gain because the Campbell stock was held less than a month before it was sold, and ask for a recomputation of the deficiency upon that basis and a claim for whatever increased deficiency that that might result in."

/s/ CHARLES W. DAVIS,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
District Counsel.

E. C. CROUTER,

R. E. MAIDEN, JR.,
Special Attorneys, Bureau of Internal Revenue.

Received and filed June 11, 1952, T. C. U. S.

Served June 12, 1952.

[Title of Tax Court and Cause.]

REPLY TO AMENDMENT TO ANSWER

Comes Now Seaboard Finance Company, petitioner in the above cause by its attorney, and as a reply to the amendment to the answer heretofore filed in this proceeding, admits, alleges, and denies as follows:

VII.

Denies each and every allegation contained in Paragraph VII of respondent's amendment to answer.

Respectfully submitted,

/s/ AUSTIN H. PECK, JR.
Attorney for Petitioner.

Lodged June 19, 1952.

Received and filed June 19, 1952, T.C.U.S.

Served June 20, 1952.

The Tax Court of the United States

Docket No. 30554

[Title of Cause.]

Promulgated May 21, 1953.

FINDINGS OF FACT AND OPINION

Application of Canadian currency which had appreciated in value since original acquisition to consummate purchase of stock in Canada at fixed price

in Canadian dollars held, on facts, not to result in independently realized gain on foreign exchange.

For the Petitioner:

AUSTIN H. PECK, JR., ESQ.

For the Respondent:

R. E. MAIDEN, JR., ESQ.

Respondent determined a deficiency of $70,590.74 in petitioner's income tax liability for the fiscal year ended September 30, 1947. Petitioner has conceded certain adjustments. The sole remaining question is whether petitioner's application of previously acquired Canadian currency, which had appreciated in value since its original acquisition, to consummate the purchase of the capital stock of a Canadian corporation resulted in an independently taxable gain, realized in Canada, apart from any gain realized on the subsequent sale of that stock.

Findings of Fact

Most of the facts have been stipulated and are found accordingly.

Petitioner is a corporation organized under the laws of the State of Delaware. Its principal business office is located in Los Angeles, California. A federal income tax return for the fiscal year ended September 30, 1947, was filed on its behalf on the accrual basis with the collector for the sixth district of California.

Petitioner is engaged in the small loan business. This business consists of making secured and unse-

cured loans, usually to individuals. During the period here in question the average loan made by petitioner was $310.

In 1946 Campbell Finance Corporation Limited, hereinafter called Campbell, was a corporation organized and existing under the laws of the Providence of Ontario, Dominion of Canada. It was then engaged in the small loan business in Canada, operating approximately 50 offices, with aggregate loans outstanding as of March 31, 1946, of approximately $5,965,802 (Canadian).

In January, 1946, Campbell had 50,000 shares of common stock being the only issued and outstanding shares of stock of the corporation. On and immediately prior to January 2, 1946, all of these shares were owned by Industrial Acceptance Corporation, Limited, a Canadian corporation, hereinafter called Industrial.

Industrial's principal business is, and was, except for its ownership of Campbell stock, the discounting of commercial installment paper for Canadian dealers in automobiles, furniture, farm implements, and other property. It was not actively engaged in the small loan business as such except through its ownership of the Campbell stock. Industrial had acquired all of the Campbell stock in 1940, holding it until the end of World War II as a means of compensating for the decrease in its regular business of discounting paper, the latter business having declined during the war period because of shortage of automobiles and other equipment.

In about December, 1945, W. A. Thompson, who was then president of petitioner and who was, at the time of the hearing, the chairman of the board of directors of petitioner, was advised that Industrial desired to sell the 50,000 Campbell shares. In January or February, 1946, Thompson, Paul A. Appleby, who was then vice-president of petitioner, and Frederick N. Towers, petitioner's general counsel, went to Montreal, Canada, to discuss with officials of Industrial a possible acquisition of the Campbell stock.

At that time the officers of Industrial offered to sell the Campbell stock to petitioner for a price equal to the net worth of Campbell, according to its books, plus $1,000,000. In terms of Canadian dollars, Industrial's asking price for the Campbell stock was $2,214,969.94.

Except through utilization of the method ultimately included in the purchase agreement, petitioner did not have sufficient cash resources, either in capital or ability to borrow, to meet Industrial's asking price in cash. Except through utilization of the method ultimately used in the purchase agreement, it could not pay the cash price and still have funds available with which to finance the operations of Campbell. The officers of petitioner discussed a proposal from which emerged the concrete offer made to Industrial on March 27, 1946. On that date petitioner and Industrial entered into a written agreement substantially incorporating petitioner's proposal, and providing in part as follows:

* * *

The provisions of this Agreement * * * were in contemplation of the parties hereto on January 2, 1946, and it is therefore the intention of said parties that this agreement shall be and become effective as of said date.

Seller [Industrial], with all convenient speed following the execution of this agreement, will transfer and deliver to Purchaser [petitioner] 50,000 shares of the authorized, issued and fully paid common stock of Campbell Finance Corporation, Limited, an Ontario Corporation (sometimes hereinafter referred to as "Campbell"), and Purchaser will contemporaneously cause to be lawfully issued to Seller and delivered to the Canadian Bank of Commerce, in escrow, 100,000 shares of its presently authorized common stock.

* * *

Purchaser will proceed with all convenient speed with the preparation and submission to the Securities and Exchange Commission of the United States of a registration statement covering the said 100,000 shares issued by Purchaser to Seller under the terms of this Agreement. Purchaser reserves unto itself the right, in its sole discretion, to register with said Securities and Exchange Commission other and additional of its securities contemporaneously with the registration of the shares so delivered to Seller. Such registration is to be at the sole expense, cost and risk of the Purchaser, and the Seller shall not be held responsible for any act or omission with reference thereto, except to the extent that should any factual data contained in said registration statement

be furnished to Purchaser by Seller, Purchaser may accept the same as being true and accurate in all respects.

Purchaser shall effect appropriate arrangements with investment bankers to be selected by it for the sale to said investment bankers of the shares so issued by Purchaser to Seller, together with such additional shares (if any) as may be required to carry out the undertaking of the Purchaser hereunder, and from the proceeds of such sale Seller shall be entitled to have, receive and retain the sum of $2,214,969.94. If on the sale to said investment bankers of the said 100,000 shares of common stock as above provided, the net proceeds of such sale actually received in cash by the Seller shall not equal or exceed the sum of $2,214,969.94, Purchaser undertakes to make good to the Seller any deficiency in said amount through either or both of the following media, namely:

(a) by issue and delivery to Seller of additional shares of the common stock of Purchaser for sale to said investment bankers as hereinabove already contemplated, with the right to Seller to have and receive the net proceeds of sale thereof to the extent necessary to make good any deficiency as aforesaid; or

(b) to pay to the Seller the amount in cash equal to such deficiency.

The Purchaser further undertakes to indemnify and save harmless the Seller in respect of any and all cost and/or expense to the Seller by way of

transfer taxes and/or otherwise in connection with the transfer and delivery of the 100,000 shares by the Seller to investment bankers for purposes of sale of said shares by the latter as above provided.

In the event of the net proceeds of sale of said 100,000 shares to the investment bankers being in excess of $2,214,969.94, then Seller will instruct and direct said investment bankers to pay over and distribute such excess to Purchaser.

In conformity with the requirements of the Securities Act, 1933, of the United States of America, and the regulations pursuant thereto, Seller and Purchaser agree that the said 100,000 shares of the common stock of Purchaser shall be held by the Canadian Bank of Commerce, in escrow, for the following purposes, namely:

(a) To deliver said 100,000 shares of the common stock of Purchaser to said investment bankers, as hereinabove provided, upon receipt from Purchaser, at any time prior to November 30th, 1946, of a certificate to the effect that a registration statement concerning the said 100,000 shares has been duly filed with the Securities and Exchange Commission of the United States of America and that said registration has become effective, and upon receipt from Seller of written authorization to make such delivery; or

(b) To deliver said 100,000 shares to Purchaser at any time upon receipt of written instructions to that effect from both Seller and Purchaser; or

(c) To deliver said 100,000 shares to Seller at

any time subsequently to November 30th, 1946, upon written instructions to that effect from Seller.

In the event of delivery of said 100,000 shares to Seller as next hereinabove contemplated, Seller covenants that it will not offer the whole or any part of said shares for sale in the United States of America without first complying with all requirements of said Securities Act, 1933.

Pending ultimate receipt by Seller of the sum of $2,214,969.94 as provided in this agreement, Purchaser recognizes that Seller is entitled to reasonable compensation for delayed receipt by Seller of said amount. The parties therefore agree that a proper admeasurement of such compensation shall be interest upon the said $2,214,969.94 from January 2nd, 1946, to date of receipt of said full amount by Seller at the rate of 4½ per centum per annum. Against the amount of such compensation, however, Seller shall credit any and all net proceeds by way of dividends that may be actually received by Seller upon the said 100,000 shares delivered to Seller under the terms hereof.

So long as the said 100,000 shares of the common stock of Purchaser have not been sold to said investment bankers, as hereinbefore contemplated, and provided that Purchaser has not sold or disposed of the whole or any part of said 50,000 shares of Campbell (with the exception of the seven shares thereof required under the terms hereof to be transferred and delivered to the nominees of Seller), then Purchaser may, at any time prior to November 30th, 1946, repurchase the said 100,000 shares from Seller

for and in consideration of the transfer and delivery by Purchaser to Seller of said 50,000 shares of Campbell and the payment to Seller of the sum of $100,000.00 together with a further sum equal to the actual damage, if any, caused to Campbell by reason of any acts of Purchaser. Notice of the intention of Purchaser to repurchase the said shares of the common stock of Purchaser shall be given by registered letter addressed to Seller and delivered to the Executive Offices of Seller in the Sun Life Building, Montreal, at any time up to and including the 30th day of November, 1946. Following said notice Purchaser shall transfer and deliver to Seller said 50,000 shares of Campbell and shall pay to Seller said sum of $100,000.00 at said Executive Offices of Seller not later than twenty (20) days following the date of delivery of said notice, and Seller shall thereupon instruct the Canadian Bank of Commerce to deliver to Purchaser said 100,000 shares of the common stock of Purchaser. The amount of actual damages, if any, caused to Campbell by reason of any acts of Purchaser shall thereafter be ascertained and, if there is no agreement thereon or agreed settlement thereof, the matter shall be submitted to the arbitration of some person to be chosen by Seller and Purchaser, or, if they cannot agree on one person, then to two persons, one to be chosen by Seller and the other by Purchaser, and a third to be appointed by the two persons first chosen, or, on their failing to agree, then by a Judge of the Superior Court for the District of Montreal.

The award shall be conclusive as to the amount of the damage, and shall be payable within fifteen (15) days of the date thereof. If the full amount of the claim for damages is awarded, the costs shall follow the event, and, in other cases, all questions of costs shall be in the discretion of the arbitrators.

If on or before November 30th, 1946, Purchaser has not given notice to Seller of Purchaser's intention to repurchase from Seller the said 100,000 shares of the common stock of Purchaser and Seller shall not have received full payment of the sum of $2,214,969.94 hereinbefore referred to, together with compensation for delay in receipt thereof as herein provided, Purchaser shall thereafter be in default and Seller shall thereupon be entitled to demand and to have and receive from Purchaser any balance still unpaid to Seller of the said sum of $2,214,-969.94, together with compensation for delay in receipt thereof as aforesaid.

To protect and indemnify Seller against any loss that might or could arise or result from Purchaser's election to repurchase its said shares, as above provided, and/or from Purchaser's default as defined in the paragraph next hereinabove, Purchaser agrees to deposit with Seller as cash collateral security concurrently with the transfer and delivery of said 50,000 shares of Campbell as hereinbefore provided, the sum of $2,200,000.00 and Seller agrees that it will credit to the account of Purchaser interest at the rate of 4½ per centum per annum on said amount or any part thereof for the period during which said amount or part thereof so remains

on deposit as cash collateral security with Seller.

Should the proceeds of the sale of said 100,000 shares of the common stock of Purchaser to the investment bankers, as hereinabove provided, be not delivered to Seller, or be insufficient when delivered to Seller to equal or exceed the sum of $2,214,969.94 together with compensation for delay in receipt thereof as herein provided, or should Purchaser notify Seller of Purchaser's intention to repurchase from Seller the said 100,000 shares of the common stock of Purchaser as above provided upon payment to Seller of said sum of $100,000.00 and together with a further sum equal to the damages, if any, as aforesaid, then Seller may, to the extent that any amount due to Seller hereunder has not been paid, take, have and retain from the said sum of $2,200,000.00 so deposited by Purchaser as cash collateral security with Seller an amount sufficient fully to pay to Seller all amounts due to Seller hereunder, and the balance, if any, of said sum so deposited shall thereafter be returned by Seller to Purchaser, with interest as aforesaid. In the event of Seller being in possession or in control of any of the said 100,000 shares or of any proceeds of sale of any thereof after ultimate receipt by Seller of the above-mentioned sum of $2,214,969.94 and compensation for delay in payment thereof, as above provided, then Seller will account to Purchaser in respect of any of said shares or proceeds of sale as aforesaid so still in Seller's possession or under its control.

Pending ultimate receipt by Seller of the said sum of $2,214.969.94, Purchaser covenants and

agrees that it will not sell or otherwise dispose of said 50,000 shares of Campbell and that Purchaser will give to Seller, or to Seller's nominees, a proxy to permit Seller, or said nominees, to vote said common shares of Campbell at all meetings of shareholders of Campbell and that Purchaser will transfer and deliver to nominees of Seller seven (7) shares of Campbell to qualify said nominees to act as directors of Campbell. Seller covenants and agrees that it will procure for Purchaser the resignations of all of said nominees of Seller as directors of Campbell upon receipt of said sum of $2,214,-969.94. Purchaser further covenants and agrees that pending ultimate receipt of said sum there will be no changes in the management of Campbell without the consent of Seller and that the bookkeeping system of Campbell and the fees paid by Campbell to Seller for the use of Seller's bookkeeping machinery shall continue as presently constituted.

* * *

It is specifically understood and agreed by and between the parties to this Agreement that in each and every instance in which the payment, deposit, exchange, adjustment or distribution of money is involved under the terms hereof, such payment, deposit, exchange, adjustment or distribution shall be in Canadian funds in the City of Montreal, excepting only in the event of the sale of shares to the investment bankers, as hereinbefore provided, resulting in an excess over and above the amount to which Seller is entitled, then such excess shall be-

long and shall be payable to Purchaser by the investment bankers in whatever funds or currency such excess may then be.

* * *

Petitioner would have preferred to have made a cash offer for the Campbell stock in an amount substantially less than Industrial's asking price. The acquisition of the Campbell stock by the method set forth in the above contract was necessary in order to meet Industrial's demand that payment of the purchase price be made in cash.

The funds required by petitioner in order to carry on its activities have been d e r i v e d from three sources: (a) equity capital, consisting of preferred and common stock: (b) bonds or debentures; and (c) money borrowed from banks. In 1946 the banks with which petitioner did business limited the total amount of unsecured loans to petitioner at any time to twice petitioner's equity capital, including as equity capital for this purpose all subordinated obligations.

The following table discloses the ratios between petitioner's equity capital, including subordinated obligations, and loans from banks as of the dates indicated:

Date	Superior Indebtedness (Bank Loans)	Equity Capital & Subordinated Obligations	Borrowing Ratio	Ratio had the 100,000 Seaboard shares not been issued to Industrial
Jan. 31, 1946	$10,750,000	$ 7,089,157	1.5-1	
Feb. 28,1946	11,250,000	7,386,673	1.5-1	
Mar. 31, 1946:				
Before execution of contract with Industrial	13,079,366	7,999,228	1.6-1	
After execution of contract with Industrial	17,729,366	9,249,228	1.9-1	2.2-1
June 30, 1946	22,625,000	10,790,427	2.1-1	2.5-1
Dec. 31, 1946				
After sale	21,842,500	12,106,238	1.8-1	2.0-1

Petitioner believed that its common stock would appreciate in value as soon as the public received information that the Campbell stock had been acquired.

During the year 1946, the common stock of petitioner was not listed on any national securities exchange. It was, however, traded in the over-the-counter market. The over-the-counter quotations on the common stock of petitioner on the various dates indicated were as follows:

Date	Bid	Ask
1/ 9/46	14⅝	15⅜
1/15/46	14¼	15
3/ 1/46	13½	14½
3/15/46	13¾	14½
3/26/46	15¾	16½
3/27/46	16¼	17
4/ 2/46	17¼	18
4/15/46	17¾	18½
4/30/46	18½	19½
5/15/46	18½	19¼

Date	Bid	Ask
6/ 3/46	21	22
6/ 7/46	22	23
7/16/46	21½	22½
8/27/46	19¼	20¼
9/ 4/46	17	18
9/ 5/46	16½	17½
9/27/46	16¼	17¼
10/31/46	15½	16½
11/22/46	16¼	17¼

At the time that the negotiations for acquisition of the Campbell stock were being carried on, petitioner had a line of credit with the Bank of the Manhattan Company in the amount of $2,000,000 (United States). Said bank was willing to loan that amount to petitioner for use in connection with the agreement between petitioner and Industrial of March 27, 1946.

On March 27, 1946, petitioner, through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares of its common stock in the name of Industrial, and caused the same to be delivered to the Canadian Bank of Commerce, to be held in escrow. From and after said date of issuance, Industrial appeared on the stock transfer records and on the share register of petitioner as the owner of 100,000 shares of common stock of petitioner.

On January 28, 1946, prior to the issuance of the 100,000 shares of petitioner's stock to Industrial, petitioner's counsel sent a letter to the Securities and Exchange Commission which read, in part, as follows:

* * * The Company [petitioner] is contemplating

an expansion program, divided into two parts * * *

The Company believes it will be enabled to purchase a Canadian finance company on the basis of issuing in payment therefore [sic] certain shares of its common stock on condition that it will guarantee to the seller that it can find a purchaser to distribute the stock to the public within the next seven or eight months. Obviously, under such state of facts, I do not believe the seller, in taking such shares, can be considered to take them for investment but for the purpose eventually of making a public distribution thereof and I think, therefore, registration will be required and have so advised the Seaboard people. The question presented is whether or not there would be a violation of the law if Seaboard were to issue those shares to the seller at this time. In this connection, I have advised Seaboard that, in agreeing to issue the shares, they should insist that the shares be deposited in escrow with a bank, to remain escrowed until such time as a registration statement is in effect, else the shares being in the hands of the seller he might undertake to distribute them irrespective of commitment and before the registration were effected.

The second part of the financing contemplates the sale of shares through an underwriter some time during the summer for the purpose of providing additional capital to Seaboard. Obviously, therefore, it is Seaboard's intention to register both blocks of stock at the same time, thus saving expenses of registration. The seller is not objecting to the fact

the shares he will receive are not now free for sale. He is satisfied to wait the necessary six or seven months, so the real issue involved is the issuance of stock in payment for the property to be purchased plus the undertaking on the part of Seaboard to find a purchaser for that stock and an underwriter to do a public offering, with probably a dollar and cent contingent commitment in the event of non-performance.

* * *

Unless the transaction is handled in the form of the issuance of stock in payment for the property, Seaboard will be required to issue a note or other paper obligation, which must show up on its balance sheet as a quick liability. This would somewhat defeat the purpose of the transaction, whereas the issuance of stock with a contingent liability only to find an underwriter would not adversely affect the Company's balance sheet.

* * *

On February 6, 1946, a member of counsel for the Securities and Exchange Commission, replied to petitioner's counsel in part as follows:

The issuance of stock in connection with the acquisition of the Canadian company and the offering of securities for the purpose of raising additional capital appear to be a part of a general plan for the company's financing. If the shares to be issued to the Canadian company will be accompanied by appropriate restrictions preventing any distribution thereof prior to the effective date of the registration

statement, I should not be inclined to raise any objection to the postponement of registration until such time as the offering to the public will occur. * * *

On March 27, 1946, Industrial caused to be transferred and delivered to petitioner a certificate or certificates evidencing 50,000 shares of the common stock of Campbell. From and after that date, and until petitioner sold the Campbell stock, petitioner appeared on the stock transfer records and the share register of Campbell as the owner of 50,000 shares which constituted all of Campbell's capital stock.

On or about March 30, 1946, petitioner issued its check to the Canadian Bank of Commerce in the amount of two million United States dollars, with instructions to buy $2,200,000 in Canadian dollars for petitioner's account. Canadian dollars in the required amount were purchased for petitioner's account and deposited with Industrial pursuant to their agreement of March 27, 1946. Industrial duly acknowledged receipt of the deposit. The two million United States dollars were borrowed by petitioner from the Bank of the Manhattan Company.

In acknowledging receipt of petitioner's check drawn on the Bank of the Manhattan Company, the letter from the Canadian Bank of Commerce said in part:

We have received [from Industrial] a receipt for $2,200,000 Canadian funds and certificates duly endorsed representing 50,000 shares of common stock of Campbell Finance Corporation, Limited. We record that under the instructions contained in your

letter these certificates are to be held until we receive from you 100,000 shares Seaboard Finance common stock, after which the 50,000 shares of Campbell Finance Corporation stock are to be forwarded to you by registered mail.

* * *

On or about May 4, 1946, petitioner commenced the preparation of a registration statement for filing with the Securities and Exchange Commission in Washington, D. C. This statement was filed on August 29, 1946, and became effective on November 22, 1946. It registered 50,000 shares of series A cumulative preferred stock and 200,000 shares of common stock. The prospectus which was prepared and filed as part of the registration statement stated, in part:

Under the terms of the agreement of purchase and sale, * * *, [petitioner] in payment for all the 50,000 outstanding shares of Common Stock of Campbell, has issued 100,000 shares of its Common Stock, which have been deposited in escrow with the Canadian Bank of Commerce pending the completion of arrangements by * * * [petitioner] with investment bankers for the public sale of said 100,000 shares of Common Stock for the account of Industrial and the registration thereof under the Securities Act of 1933, all of which is to be done by the Company without expense to Industrial. The agreement further provides that Industrial Acceptance Corporation, Limited, shall have no responsibility for any statement made in the Registration Statement, except to the extent that it supplied information

for the Registration Statement. The first 100,000 shares being offered under this Prospectus are the 100,000 shares issued by the * * * [petitioner] to Industrial and are being offered for the account of Industrial Acceptance Corporation, Limited. There is no affiliation between Industrial Acceptance Corporation, Limited, and the * * * [petitioner] * * *.

If the proceeds to Industrial from the sale of the 100,000 shares of Common Stock do not equal or exceed the sum of $2,214,969.94, Canadian funds, the Company must make good the amount of any deficiency * * *.

Under date of November 22, 1946, petitioner and Industrial entered into an underwriting agreement with Van Alstyne, Noel & Co., Johnston, Lemon & Co., and Crowell, Weedon & Co., pertaining to the shares registered as above described. In the first paragraph of that agreement it was stated that petitioner "proposed to issue and sell an aggregate of 100,000 shares of common stock of the par value of $1 each, and the undersigned common stockholder, Industrial Acceptance Corporation, Limited, hereinafter sometimes referred to as the 'Selling Stockholder,' proposed to sell an aggregate of 100,000 shares of outstanding common stock of the par value of $1 each of the Company."

The preparation and filing of the Registration Statement was delayed because of problems encountered in the completion of an audit of Campbell and petitioner.

The delay between the effective date of the Registration Statement and the marketing of Industrial's 100,000 shares of stock of petitioner was attributable to the fact that the underwriters refused to make a public offering of stock in petitioner because of then existing market conditions.

Of the 200,000 shares of common stock registered as above described, 100,000 shares were offered for sale to the public on or about November 22, 1946. These shares were the shares which had been issued by petitioner to Industrial.

The net proceeds, after deduction of underwriting commissions, from the sale of the 100,000 shares of stock in petitioner were $1,440,000. On November 30, 1946, petitioner sent the following letter to Industrial:

November 30, 1946.

Mr. J. P. A. Smyth, President,
Industrial Acceptance Corporation Limited,
Sun Life Building,
Montreal, Canada.

In re: Seaboard Finance Company.

Dear Mr. Smyth:

As per our conversation of today, I hereby confirm the purchase of Campbell Finance Corporation Limited in accordance with the terms of contract dated as of January 2, 1946.

In accordance with the terms of the Underwriting Agreement dated November 22, 1946, between your corporation, our corporation and the underwriters

therein mentioned, we have arranged the sale for your account of 100,000 shares of our common stock issued to you to net you $14.40 per share. We hereby guarantee to you payment of said sum and hold you harmless against any loss in connection with the sale of said stock under the terms of said contract.

For convenience between us and without in any way intending to change the ownership of said shares, we authorize you to charge against the $2,200,000 good faith deposit held by you an amount equal to the proceeds from the sale of this stock provided you will instruct Guaranty Trust Company of New York, to which you will send this stock for delivery to the underwriters, to deposit the proceeds to our account for your credit.

The balance of the purchase price of the Campbell shares you are also authorized to deduct from the deposit fund held by you.

* * *

Petitioner paid dividends to Industrial on account of the 100,000 shares of common stock of petitioner held by Industrial in the total amount of $72,000 (Canadian); and interest, pursuant to the provisions of the agreement of March 27, 1946, in the amount of $21,938.99. During the same period Industrial paid or credited to petitioner interest on $2,200,000 (Canadian) deposited pursuant to the terms of the agreement of March 27, 1946, in the total amount of $69,164.38 (Canadian). The dividends paid to Industrial on the 100,000 shares of petitioner's stock issued under the agreement of

March 27, 1946, were credited against petitioner's interest obligation to Industrial.

On March 27, 1946, and April 1, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was .9090. In November and December, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was par, less one-half of 1 per cent on conversion, or an effective ratio of .995, which had been in effect since July 5, 1946.

In August, 1946, Industrial offered for sale to the public $2,000,000 of its 3½ per cent twenty-year sinking fund debentures series "A," and under date of August 26, 1946, circulated a prospectus relating to that offer. The prospectus contained the following statement relative to Campbell Finance Corporation Limited:

In 1940 when it became evident that the manufacture of automobiles, radios, refrigerators and other durable consumer goods would be curtailed for the duration of the war the Company purchased all of the capital stock of Campbell Finance Corporation Limited (then known as Campbell Auto Finance Company Limited) in order to provide another avenue for the employment of the Company's resources. The business of Campbell Finance Corporation Limited consisted principally of making small loans under the Dominion Small Loans Act of 1939 and operated from its head office in Toronto as well as three branches in the Province of Ontario. Facilities available through the country-wide network of branches of Industrial Acceptance Corpora-

tion Limited made it possible to develop a very substantial and profitable small loans business during the intervening years, thus materially assisting the company to maintain its branch organization and earnings.

With the prospect of the return of instalment sales financing in larger volume than has been enjoyed by the Company in the past, the Directors entered into an agreement with Seaboard Finance Company, one of the larger personal loan companies in the United States, for the sale of all of the shares of Campbell Finance Corporation Limited as at January 2nd, 1946, at a price which gives Industrial Acceptance Corporation Limited a very substantial profit on its investment. As a result of this agreement the Company will withdraw from the small loans field and will have available for its regular instalment sales finance business all of the capital employed in that business before the war, plus the profit realized. The Company has received 100,000 shares of the common stock of Seaboard Finance Company and the latter has undertaken to arrange for the sale of these shares on or before November 30th, 1946, and has guaranteed to Industrial Acceptance Corporation Limited the receipt of $2,214,970. Until November 30th, 1946, Seaboard Finance Company may be relieved of this guarantee by returning the shares of Campbell Finance Corporation Limited and making payment of substantial sums of cash to Industrial Acceptance Corporation Limited. Seaboard Finance Company has deposited with the

Company cash collateral of $2,200,000 to guarantee the fulfillment of its obligations.

Industrial did not want to become, and did not intend to become, a stockholder of petitioner; and petitioner did not want Industrial to become a stockholder.

Petitioner was not a dealer, trader, speculator, or investor in foreign exchange.

Petitioner sold all of its Campbell stock on December 31, 1946.

Petitioner's use of foreign exchange in the purchase of the Campbell stock, in accordance with obligations incurred under the purchase contract of March 27, 1946, did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of the stock. Respondent properly eliminated the gain on foreign exchange reported by petitioner in its return for the taxable year involved.

OPINION

Opper, Judge.

Although the facts and particularly the details of the arrangement giving rise to the present controversy are complicated and the contentions of the parties cover a wide range of discussion, the central problem seems to us not so involved as might at first appear. Petitioner committed itself to purchase stock of a Canadian corporation which for convenience we call the Campbell stock, guaranteeing to the seller the sum of $2,214,969.94 in Cana-

dian dollars. This amount was to be realized first, out of the sale of 100,000 of petitioner's shares issued to the seller, but to be sold by petitioner, and secondly, from petitioner's agreement to make good to the seller any deficit. As security petitioner was required to deposit in escrow $2,200,000 Canadian, as well as the shares of its stock, pending completion of the details of sale. Petitioner purchased the $2,200,000 Canadian for $2,000,000 United States almost immediately after the execution of the agreement. Some seven months later, after its stock had been marketed for an amount substantially less than the guaranteed price, petitioner authorized the purchaser to apply the deposit to the purchase price.

In the meantime Canadian exchange had risen in value to a point where petitioner claims it realized a gain on the Canadian dollars of the difference, $189,000, between the exchange rate at the time they were purchased and at the time they were turned over to the seller of the Campbell stock. The reason for the peculiar contention by the taxpayer that it has realized a gain contrary to respondent's determination that it has not, is petitioner's position that the gain having taken place in Canada it constitutes the basis for a credit against its United States tax which apparently both parties agree would result in a computation beneficial to petitioner.

We find it unnecessary to pass upon what respondent refers to as his primary argument. It is that the doctrine of such cases as Bernuth Lembcke Co., Inc., 1 B.T.A. 1051, acq. IV-2 C.B. 3, and Joyce-

Koebel Co., 6 B.T.A. 403, acq. VI-2 C.B. 4, is not applicable to isolated or single transactions involving foreign exchange. See American Pad & Textile Co., 16 T. C. 1304. Even if the doctrine of those cases were applicable to these facts, we think petitioner could not succeed.

The basic principle of those cases may be summarized by a quotation from Bernuth Lembcke Co., Inc., supra, 1054;

> * * * The creosote oil could not be inventoried * * * at more than its actual cost and the cost was in terms of the exchange at the date of purchase. * * * [Emphasis added.]

Applying that concept here, the cost of the Campbell stock would be the $2,214,969.94 Canadian converted into United States dollars at the rate of exchange prevailing on the date of purchase, March 27, 1946. As we have said, at approximately the same date and at no different rate of exchange, petitioner purchased $2,200,000 Canadian which it used in connection with the purchase.

The remaining analysis must be stated in terms of hypotheses since both parties deal with the subject in alternatives not necessarily consistent with each other. But on any approach the result is a dilemma from which petitioner cannot escape. If, on the one hand, the Canadian dollars were actually used to pay the purchase price, then no gain or loss on foreign exchange could have resulted[1] in view of the fact that the exchange rate on the date of pur-

[1]There is a difference of $14,969.94 Canadian not accounted for by these transactions. No point is

chase of the Campbell stock and of the Canadian dollars was apparently identical. If on the other hand the use of the Canadian dollars which actually took place was, as petitioner contends, a mere short-cut for a longer operation which would have involved the conversion of the Canadian dollars into American funds and the purchase of Canadian dollars at that time out of the proceeds of the sale of petitioner's stock, then, if we apply the doctrine of Bernuth-Lembcke Co., Inc., supra, any gain on the purchase and sale of the Canadian dollars would be offset by the loss sustained between the purchase price of the Campbell stock converted into dollars at the date of purchase and the amount of American dollars required to purchase the same number of Canadian dollars when payment was subsequently made. See James A. Wheatley, 8 B.T.A. 1246, acq. VIII C.B. 34.

Petitioner attempts, it is true, to escape from this difficulty by the contention "that there is not an inflexible rule of application to these foreign exchange cases. Certainly * * * where petitioner could not determine its cost until certain events occurred it would be error to rule that the cost was determined on March 27, 1946." With deference, this appears to us to be an argument in a circle. We assume that under the principles stated petitioner

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made of this amount, however; the record fails to show in what manner it was discharged or at what point the complicated accounts between petitioner and the seller took it into effect. We accordingly disregard this comparatively small element both for failure of proof and because it appears not to be in controversy.

could and should have determined its cost as of March 27, by the mere process of computing from the fixed amount of $2,214,969.94 Canadian at the then rate of exchange its cost in American dollars. In the end result and regardless of what occurred on the marketing of the stock, those Canadian dollars were required to be paid. If the cases in question are applicable petitioner could have computed its cost. And they therefore cannot be held inapplicable on the ground that petitioner could not compute its cost.

There is a third possibility that on account of the complicated nature of the transaction, it might be contended that petitioner merely borrowed the funds with which the Canadian dollars were secured, and later repaid them; or that petitioner in effect loaned the Canadian dollars to the seller pending the completion of the details of purchase; but in either event no gain or loss would have taken place. North American Mortgage Co., 18 B.T.A. 418; see B. F. Goodrich, 1 T.C. 1098; American Pad & Textile Co., supra.

Viewing the matter practically and eliminating as far as possible the complications of detail, petitioner was in fact no better off or worse off by reason of its transactions in Canadian currency. Whether we deal with the subject as a matter of form or of substance, it accordingly follows that no gain was realized and that the deficiency was correctly determined.

Decision will be entered for the respondent.

Served May 21, 1953.

The Tax Court of the United States
Washington

Docket No. 30554

SEABOARD FINANCE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated May 21, 1953, it is

Ordered and Decided: That there is a deficiency in income tax of $70,590.74 for the fiscal year ended September 30, 1947.

[Seal] /s/ CLARENCE V. OPPER,
Judge.

Entered May 21, 1953.

Served May 22, 1953.

The Tax Court of the United States

Docket No. 30554

SEABOARD FINANCE CO.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PROCEEDINGS

May 23, 1952—10:00 A.M.

(Met pursuant to notice.)

Before: Honorable Clarence V. Opper, Judge.
Appearances:

AUSTIN H. PECK, JR.,
Appearing for the Petitioner.

R. E. MAIDEN, JR.,
(Honorable Charles W. Davis, Chief Counsel, Bureau of Internal Revenue),
Appearing for the Respondent.

* * *

W. A. THOMPSON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Peck:

Q. Mr. Thompson, please state your name.

A. W. A. Thompson.

(Testimony of W. A. Thompson.)

Q. What is your business address?

A. 945 South Flower Street, Los Angeles 13.

Q. What is your present occupation?

A. Board chairman of the Seaboard Finance Company.

Q. That is the Petitioner in this proceeding?

A. It is.

Q. In 1946, were you an officer of the Petitioner, Seaboard? A. I was president in 1946.

Q. How long have you been engaged either individually or as an officer of the corporation in the small loan business? [40*] A. 29 years.

Mr. Peck: If your Honor please, I should like to present at this time the written stipulation of facts. I present now the original and one copy. The copy does not have attached to it the exhibits.

The Court: The stipulation will be received. Can you tell me the number of the last exhibit?

Mr. Peck: Yes. The last exhibit attached to the stipulation was marked K-11.

The Court: Thank you.

(The document heretofore marked Joint Exhibits Nos. A-1 through K-11 was received in evidence.)

Q. (By Mr. Peck): Mr. Thompson, directing your attention to the year 1946, are you familiar with the transaction between Seaboard and Industrial Acceptance Corporation relating to the stock of the Campbell Finance Corporation?

A. Yes, sir.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Testimony of W. A. Thompson.)

Q. Were you at any time advised that the Campbell stock could be acquired? A. I was.

Q. When did you first learn of this?

A. My recollection is that it was in December of 1945.

Q. Did you at that time discuss with anyone in your organization the possible acquisition of that stock? [41]

A. Somewhere about that time, yes.

Q. With whom in your organization did you discuss it?

A. With the officers and directors of the company.

Q. Did you discuss the possible transaction with officials of Industrial Acceptance Corporation?

A. That was sometime in 1946. Three of us went to Montreal, Canada.

Q. Who went on that trip?

A. Paul Appleby.

Q. What was his office?

A. Vice-president of Seaboard. Frederic N. Towers was general counsel. There had been some previous discussions with Industrial by other people with the company, but they were what I would term preliminary.

Q. When you went to Montreal, that was sometime in January of 1946?

A. January or February.

Q. Did Industrial make an offer with Campbell stock to Seaboard? A. They did, sir.

Q. Could you tell us briefly what the terms of their offer were?

(Testimony of W. A. Thompson.)

A. The terms of their offer were balance sheets, net worth plus one million dollars bonus.

Q. Represented in terms of dollars, what would that [42] have amounted to at the time? Was there any set figure?

A. Approximately $2,200,100.00. I might add that I think it is the exact sum that has been used here, the two million two hundred and fourteen and all the rest of it.

Q. That was Industrial's asking price?

A. Yes.

Q. What action, if any, did Seaboard take with respect to that offer?

A. We, at that time, made no counter proposal to them, but inasmuch as we were not in a position to do so, not having the cash resources, either capital or ability to borrow the amount required, we had certain talks with investment bankers regarding raising the amount that would be indicated.

Q. Did the officers of Seaboard discuss at any time any different proposal with Industrial?

A. Not until we finally made a concrete proposal to them sometime in March which finally resulted in a contract dated, I believe, March 27th.

Q. What was the nature of that proposal? Was it substantially the proposal embodied in the final written agreement? A. Substantially, yes.

Q. Now, can you tell us why the proposal embodied in it, which was ultimately embodied in the written, was made by Seaboard in lieu of a cash offer? [43]

(Testimony of W. A. Thompson.)

A. There were several reasons. The chief one was that we didn't have the funds available with which to make the purchase and to finance Campbell, that would become our responsibility. What we would have preferred to have done was to have raised money and made a cash offer which would have been substantially less than were the terms of this agreement, namely, the two million two Canadian. But we saw the possibility of an appreciation in our stock.

Q. You mean Seaboard stock?

A. Yes, marketwise, because public information that we were acquiring or had acquired a company such as Campbell was, would normally be bullish.

Q. Go ahead. Have you anything further to say?

A. Now, if we could sell the stock at a later date at a higher figure than what the stock was currently selling at, we would naturally be acquiring it for less money and thereby reducing this premium, which, in our opinion, was excessive.

Q. When you refer to the premium, you mean the million dollars in excess of stock, do you not?

A. Yes.

Q. Were you familiar with the status of the market for Seaboard stock in 1946? A. Yes.

Q. Do you know what happened to the market for [44] Seaboard stock between, let's say March 1st to the middle of July, 1946?

A. It went up sharply, approximately fifty per cent after public knowledge of the Campbell acquisition. If we had been able to clear the registration

(Testimony of W. A. Thompson.)

statement and sold the stock, we would have had a very nice transaction.

Q. What do you mean when you say "We would have had a very nice transaction"? Will you tell us what you mean?

A. The stock was selling at that time for approximately $14.00. I don't recall the exact figure.

Q. That was in March of 1946?

A. March of 1946, prior to the signing of this contract. In June or July it reached a high of approximately twenty-two dollars and a half. If the 100,000 shares of Seaboard which was owned by Industrial had been sold at that time, that million-dollar premium would have been reduced to a very insignificant sum.

Q. In terms of cost to Seaboard?

A. In terms of cost to Seaboard.

Q. Now, Mr. Thompson, according to the stipulation of facts, Seaboard commenced to prepare a registration statement in May of 1946, but did not file it until August of 1946. Do you know whether or not there was any particular reason for that lapse of time between the commencement of preparation and the actual filing with the Securities & Exchange [45] Commission?

A. The primary reason for the delay was the question of the audit that had to be made of both companies. There was some discussion, as an illustration, as to whether the company of Haskell & Sells would also audit Campbell or whether their previous auditors would make the audit. They

(Testimony of W. A. Thompson.)

would furnish sufficient information to Haskell & Sells, who had to make the over-all certification. It ultimately worked out that the auditors who had previously audited Campbell did their audit under the supervision of Haskell & Sells. The chief reason for that being that it was considered that they could do a faster job of auditing. Campbell had approximately 50 offices and my recollection is that we had approximately 75 offices at that time.

Q. Now, it is further stipulated, Mr. Thompson, that though the registration statement was filed in August of 1946, it did not become effective until November 22, 1946. Was there any reason that you know of for the delay between the filing date and the effective date of the registration statement, and if so, will you state what that reason was?

A. Yes, sir. The reason was that the underwriters refused to make a public offering because the market, the stock market had suffered a severe drop while our statement was in registration. They subsequently agreed to sell the 100,000 shares of Industrial—that Industrial owned of [46] Seaboard, I should say—but refused to sell the additional 100,000 which the company had authorized and had filed a registration for that sale.

Q. Yes. Now, Mr. Thompson, at the time that you initiated your negotiations with Industrial relative to the Campbell Finance Corporation stock, do you know whether or not Industrial was offering the shares to any other prospective purchaser?

A. Yes. They were offering to anyone who was willing to buy or could buy.

Q. Did you have any concern about the timing

(Testimony of W. A. Thompson.)

of any transaction that you might enter into with respect to the Campbell stock?

A. Yes, sir. It was our opinion that unless we could move and move promptly that they would sell it to someone else.

Q. Yes. Now, Mr. Thompson, it is stipulated that on March 27, 1946, the 50,000 shares of Campbell stock was transferred to Seaboard. Do you know whether or not a certificate or certificates actually representing those shares were delivered to Seaboard? A. They were, sir.

Q. Where were they held by Seaboard?

A. In our safe deposit box in the Security First National Bank, except for—well, even the seven shares [47] were transferred to nominees and endorsed back to us.

Q. Now, the agreement which is attached to the stipulation, the agreement between Seaboard and Industrial, required Seaboard to deposit $2,200,000.00 Canadian for the benefit of Industrial. Do you know why that provision was placed in the agreement?

A. Yes, sir. It was to guarantee our faithful performance of the agreement as signed.

Q. Now, did Seaboard have any escape from that ageement, any means of escape?

A. Very definitely.

Q. Will you tell us in substance what it was?

A. We had the agreement stipulated that any time on or before—well, it was so the deal would be closed before the end of the year. I am sorry,

(Testimony of W. A. Thompson.)

but I don't recall the exact date. We could give them notice that we wanted to rescind the contract, in which event, we had certain things to do and they had others, one of them being that we were to give them the 50,000 shares of Campbell stock to receive the 100,000 shares of Seaboard that we had previously given them. They were to receive one hundred thousand Canadian dollars as damages plus any other actual damage that we might have done to Campbell.

Now, the reason for that was this: Frankly, we were not interested in paying two million two for this company. If we [48] couldn't sell our stock at a sufficiently high price on the market, promoted chiefly to the knowledge, the public knowledge that we had acquired, then, we didn't propose to go through with the transaction. Up to some time about the middle of November, we didn't think that we were going through with it. The transaction had been set up in such a manner that we could not be hurt. The question of any damage that might have been done Campbell was taken care of by asking them to put their own men in as members of the board of directors so that the policy of Campbell would be dictated by that board and not by Seaboard, so that there could be no damages arise through any of our actions with Campbell. During the period that that contract was in force, Seaboard borrowed money and lent it to itself. Campbell, at the going rate that Campbell had been paying previously to our acquiring control of it, to at least

(Testimony of W. A. Thompson.)

owning the stock. The difference between what we paid and what we let was in excess of the hundred thousand, damages that we would have to pay if we did not go through with the contract. In November of 1946, we were almost ready to advise Industrial that we were going to call the contract off when we heard that there was a possibility of selling it to the Household Finance Corporation. Naturally, if we could complete our transaction with Industrial and turn right around and sell it to Household for a more attractive figure, that was the business thing to do. [49]

Q. And you did that?

A. And consequently that is what we did. Household later said that they knew that we couldn't go through with it, and consequently, they were proposing to then talk to Industrial, but they had heard a rumor that we were going to sell to Commercial Credit——

Mr. Maiden: Your Honor, I want to confine this testimony here now to competent and admissible testimony. I think Mr. Thompson is getting a little bit into hearsay. I just don't know what import this testimony may have in the case, consequently I want to be sure, Mr. Thompson, that you confine it to your own personal, actual facts without resorting to rumors and hearsay, and things that you learned through devious courses.

Mr. Peck: As a matter of fact, Mr. Thompson, the sale to Household is not directly involved here in this proceeding.

(Testimony of W. A. Thompson.)

The Witness: I see.

Mr. Peck: As far as we are concerned, we don't need to go into that.

That is all the questions that I have, your Honor.

Cross-Examination

By Mr. Maiden:

Q. Mr. Thompson, Industrial had an immediate need for cash money in order to carry on its pre-war type of business. [50] Isn't it for that reason that Industrial put the Campbell stock up for sale?

A. That is not my knowledge, Mr. Maiden.

Q. Isn't it your understanding, and wasn't it your understanding, and isn't it and wasn't it a fact that Industrial before it would enter into this contract with Seaboard, required that Seaboard made available to it two million two hundred thousand cash Canadian dollars at the time of the execution of the agreement?

A. I think I understand your question. Frankly, if I do, I don't know quite how to answer it.

Q. All right. Let me restate the question, then. You stated that the provision in the contract which provided that Seaboard would deposit with Industrial two million two hundred thousand Canadian dollars upon the execution of the agreement was put in there to guarantee the performance of Seaboard under the contract. That is correct, isn't it?

A. Yes, sir.

Q. Now, I will ask you if that provision wasn't actually prompted by the insistence of Industrial

(Testimony of W. A. Thompson.)

that it have at that time available for its use as working capital in its prewar business this amount of money, that is, the $2,200,000.00?

A. That was never so expressed to me, Mr. Maiden. I might say that I was the chief architect of this transaction [51] and was in on the leading discussions.

Q. Who is Mr. A. E. Wademan?

A. A. E. Wademan is at this time the secretary-treasurer of Seaboard Finance Company.

Q. Was Mr. Wademan—am I pronouncing that correctly? A. Wademan.

Q. Was Mr. Wademan with the Seaboard Finance Company at the time of this transaction?

A. I don't believe that he was.

Q. I want to call your attention, Mr. Thompson, to a letter dated November 26, 1949, addressed to the Internal Revenue Agent in Charge, 417 South Hill Street, Los Angeles, California, re Seaboard Finance Company, and assigned and sworn to as you will notice by Mr. A. E. Wademan. You recognize his signature?

A. That is his signature.

Q. That is his signature? A. Yes, sir.

Q. Now, I call your attention to paragraph (7) in this letter on page 29, and I am going to read it to you:

"In order to meet the demands of Industrial, Seaboard deposited cash collateral security of two million two hundred thousand Canadian dollars. This fund was loaned to Industrial and Industrial paid interest for the use of the money. In this

(Testimony of W. A. Thompson.)

fashion, the immediate requirement of Industrial for [52] capital was satisfied and Seaboard was enabled to close the transaction on the only basis possible for it.''

Does that in anywise change or modify your recollection of that?

A. No, not in the least, Mr. Maiden. I was there in Montreal.

Q. It is your testimony now to the court that Industrial did not demand this two million two hundred thousand Canadian because it needed and wanted that cash at that time for use in its business?

A. Well, Mr. Maiden, the reason Jack Smith advanced to me the two million two, was for a deposit to guarantee our good faith. I also know, and if you will look at this financial statement, at that time they were not short of money.

Q. Just a second. Mr. Reporter, will you read my question?

(The question was read.)

The Witness: No. They wanted the two million two as deposit, or what I call good faith money.

Q. (By Mr. Maiden): Mr. Thompson, can you explain why it is that Industrial, if that is all they wanted, some good faith deposit money, would require you to put up all of the ultimate purchase money with the exception of $14,000.00? Doesn't that appear to you to be rather an unusual demand of earnest money, [53] or good faith money?

A. Under the circumstances, I might say that

(Testimony of W. A. Thompson.)

incidentally we tried to make it five hundred thousand or some other lesser figure, but they knew that under the conditions, under our conditions, at that time, that we could not make a cash purchase at that time.

Q. Now, isn't it a fact that Industrial was insisting upon a cash transaction and that they agreed to this method which was adopted of issuing the Seaboard stock and then going through the process of registering it and selling it on the market, wasn't that simply for the purpose of accommodating Seaboard's situation which Industrial was willing to do inasmuch as it was getting in its possession at that time all but $14,000.00 of the ultimate purchase price?

A. That is sort of an involved question. They were willing to enter into this transaction because we were giving them their asking price, knowing that the deal might not be completed by November 30th, but at least it gave them the possibility and they must have felt that it was rather strong, that they ultimately were going to get a closed transaction and get their asking price. That was their inducement.

Q. I still would like to have a comment from you as to whether or not you think that is a reasonable thing to occur, that the seller would require the purchaser to place in the seller's hand practically the entire purchase price [54] simply as earnest money, or good faith money. Don't you think that is an extremely unusual situation?

(Testimony of W. A. Thompson.)

A. Well, if I had been in their shoes, I think I would have done the same thing, if that is what you are driving at.

Q. In other words, so far as Industrial was concerned, Industrial was actually getting all but $14,000.00 of the purchase price in cash at the time of the execution of the agreement; isn't that correct?

A. No, sir, I don't think so. I will agree with you that they had the use of the two million two for that period of time, but they did not have a closed transaction at that time.

Q. I want to read to you paragraph (1) from this same letter that I just read you:

"Industrial at the conclusion of the war was anxious to return to its regular business, the financing of installment sale obligations. It had engaged in the small loan business through Campbell only as a wartime stopgap. If it was to return successfully to the desired activity, it needed to dispose of Campbell so as to obtain additional working capital."

Is that your understanding?

A. That is my understanding exactly except as to time. Otherwise, it is a true statement. Now, if this infers that they needed the money, that is not correct now; as to the future, yes. [55]

Q. Mr. Thompson, can you explain why if Industrial need any money that it would take $2,200,000.00 and pay interest on it at four and a half per cent? Can you explain that?

(Testimony of W. A. Thompson.)

A. Possibly the answer to that is this: In the first place, the going rate for money in Canada at that time was approximately four and a half per cent. That was number one. Number two, they were to get dividends or interest to equal four and a half per cent on the stock which they were taking with the potential value of two million two. So it was the standoff——

Q. What potential value are you talking about? Industrial got two million two hundred thousand cash dollars. What concern did they have with respect to the value of that 100,000 shares of Seaboard stock?

A. Their ultimate source of money was the sale of 100,000 shares of Seaboard stock and they received dividends, and if the dividends were not adequate to equalize four and a half per cent, equal four and a half per cent, we were to make up the difference.

Q. Well, the four and a half per cent that Industrial was to pay on this $2,200,000.00 was to be offset to whatever extent it received a dividend on the Seaboard stock that had been named in the name of Industrial, isn't that right?

A. No. I may have misunderstood you. If I understood [56] you correctly, the interest that they were to pay us on the deposit was to be offset by any dividend that they received. That is not my recollection, if that was your question.

Q. Well, the contract, of course, will speak for itself. I have it right here before me. Well, I will

(Testimony of W. A. Thompson.)

just let it speak for itself. I don't have it before me. I thought I did, but I don't.

Now, you would assume, would you not, Mr. Thompson, that a company that would take $2,200,000.00 at four and a half per cent interest and that represented the going rate of interest what they would have had to borrow from any other source, that the company, if they needed that money, wouldn't take it? A. Yes, sir.

Q. It is also true, isn't it, that it was quite a large indemnity that Seaboard would have to pay in the event this transaction fell through, wasn't it?

A. $100,000.00.

Q. $100,000.00. Wouldn't you call that a pretty fair security? A. What?

Q. $100,000.00 to evidence a good faith on the part of the proposed purchaser that he will buy the stock.

A. I am sorry, but I don't understand that.

Q. All right. The contract provides that if Seaboard [57] doesn't go through with this transaction that they will pay you $100,000.00?

A. Right.

Q. In addition to other considerations depending upon whatever damage might have been done to Campbell, wouldn't you say that that indemnity would be a rather substantial indemnity?

A. We tried to get it down to twenty-five thousand.

Q. That doesn't answer my question. Wouldn't you say that that was a very substantial indemnity?

(Testimony of W. A. Thompson.)

A. I don't see how I could say that, Mr. Maiden. When we did agree to it, we must have thought it was reasonable at that time.

Q. Either you thought it was reasonable at that time or you knew, of course, that you were going to go through with the transaction. Isn't that right, Mr. Thompson? A. We certainly hoped that.

Q. You actually did go through with it, did you not? A. Partly.

Q. You haven't presented anything in writing here to show that you have contemplated actually not going through with it, have you?

A. The contract, I think, intimates that we may not go through with it.

Q. That is true. The contract does furnish an out. [58]

Now, suppose you had been Industrial. You sell some of your stock under such an agreement as this for $250,000.00 and the purchaser turns over to you $249,000.00 of the purchase price at that time. So far as you were concerned, the effect would be for you to get the purchase price in cash at that time for all practical purposes, wouldn't that be the fact, Mr. Thompson?

A. Well, I certainly would have the use of the money, but there is a string on it and it can be jerked out from under me. In other words, it is not a closed transaction.

Q. Now, Mr. Thompson, it certainly was the intention of Seaboard and the understanding, of course, of Industrial that in the event nothing hap-

(Testimony of W. A. Thompson.)
pened to cause the contract to break down and not go through, that the $2,200,000.00 would to that extent represent the purchase price paid for the stock at the time the balance was struck between the parties. Isn't that correct?

A. I am sorry, but I am back of you here a couple of miles. I didn't follow that.

Q. Mr. Reporter, will you read that if you can? Read it very slowly so that Mr. Thompson can analyze it as it goes along.

(The question was read.)

The Witness: No, sir. [59]

Q. (By Mr. Maiden): You mean that is not correct, Mr. Thompson?

A. That is not correct, Mr. Maiden.

Q. In other words, you mean to represent here to this court that Seaboard did not intend that that $2,200,000.00 would be used as application on the purchase price when this contract was finally wound up?

A. Yes, sir. That was a deposit. Now, if you would like me to, I will explain the reason.

Q. Just a second. I don't understand. Do you mean to tell the Court here under oath that Seaboard did not intend that that $2,200,000.00 be actually used and applied to the purchase price of that Seaboard stock? A. Absolutely.

Q. Do you mean to tell the Court that Seaboard intended to have Industrial take those two million two hundred thousand Canadian dollars and change them into American dollars and turn them over to

(Testimony of W. A. Thompson.)

Seaboard, and then that Seaboard would take enough American money to equal the purchase price and then buy Canadian dollars and turn them over to Industrial?

A. Well, now, if you are talking about switching money back and forth, that is one thing; if you are talking about whether Industrial would get the proceeds from the sale of the stock as such, or whether they would get the two million two deposit, that is something entirely different. [60]

Q. Well, the point——

A. At least to me.

Q. The point that I am making is that you knew at the time that you entered into this contract with Industrial, and Industrial knew it, that the two million two hundred thousand Canadian dollars that it had on hand would actually be kept by them and that whatever proceeds of the 100,000 shares of Seaboard stock brought, that Seaboard would take that money. Now, isn't that a fact?

A. Well, that is sort of an involved question to me. I would like to explain to you in this way; Industrial was to get the proceeds from the sale of this common stock.

Q. Now, you are talking about the form of the contract. I want to talk about the actualities of the situation, not just the form of the contract. I am not interested in that. I want to know whether or not as an actual fact it wasn't the intention and understanding of the parties that that two million two hundred thousand cash dollars would be taken,

(Testimony of W. A. Thompson.)

kept and utilized as application of the purchase price in the event the contract didn't fall through.

A. There was no such agreement as that, if I understand your question correctly, and I believe I did.

Q. You think you do? That never entered your mind at all?

A. No, that was not part of the discussion, that I know. [61]

Q. In other words, you say that you intended to go through the exchange and later on actually take that two million two hundred thousand Canadian dollars away from them and then buying some more Canadian dollars and replace it with a later purchase of Canadian dollars?

A. The little mechanics of the things were not gone into at that time, Mr. Maiden.

Q. Well, now, looking at it from a realistic standpoint—just step back now in a purely objective manner—wouldn't it appear to you to be the reality of this situation, that the two million two hundred thousand Canadian would be used to that extent as the purchase price of the Campbell stock in the event that the contract went through, and that whatever right and claim that Industrial had on the proceeds from the sale of the Seaboard stock would be released to Seaboard?

A. I see what you are driving at. Sure, Industrial controls, just to us, the figure of two millions in America obtained from the sale of stock and controls two millions in Canada which has to

(Testimony of W. A. Thompson.)

be returned to us. I certainly would think that they would pay us with the American money rather than convert the American money into Canadian money for their own account and convert the Canadian money which they had to give back to us. They could return us Canadian and we switch [62] it back, but the proceeds of the sale of the stock was their money and not ours. It was their stock.

Q. Well, at least Seaboard and Industrial went through the form of issuing a 100,000 shares of Seaboard stock in the name of Industrial and it stated in the contract that it was Industrial stock.

A. That is right.

Q. Now, isn't it a fact that in this case Industrial wasn't interested in becoming a stockholder of Seaboard? Isn't that right?

A. I think that is right, and we didn't want to see them either too much.

Q. Industrial was wanting cash money?

A. Yes.

Mr. Maiden: All right. I believe that is all.

Mr. Peck: I have no further questions.

The Court: Is there anything further for the Petitioner?

Mr. Peck: Nothing further, your Honor.

Mr. Maiden: Nothing further, your Honor.

* * *

Filed June 15, 1952 [63]

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Docket
No. 30554

Court of Appeals

Docket No.....

SEABOARD FINANCE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit.

Seaboard Finance Company hereby petitions this Court to review the decision of The Tax Court of the United States entered May 21, 1953. Petitioner respectfully represents:

I.

Jurisdiction

This petition is filed pursuant to Sections 1141 and 1142 of the Internal Revenue Code, 26 U.S. C.A., Secs. 1141 and 1142.

II.

Nature of Controversy

The case involves Federal income tax liability of the petitioner for its taxable year ended September 30, 1947.

The deficiency determined by respondent and affirmed by the The Tax Court results from a reduction by respondent in the amount of credit claimed by petitioner under Sec. 131 of the Internal Revenue Code for income taxes paid to Canada. The credit claimed by petitioner was $230,580.91. The amount allowed by respondent and The Tax Court was $153,705.40.

The amount of the credit depends upon the amount of income realized by petitioner from sources within the Dominion of Canada during the year involved, and this, in turn, depends upon whether petitioner realized a gain of $189,000.00 in December, 1946, by reason of the application of Canadian dollars, which had appreciated in value between the date of their purchase and their said application, to the purchase of 50,000 shares of stock in Campbell Finance Corporation, Limited, a Canadian corporation. Petitioner contends that such a gain was realized, whereas respondent contends and The Tax Court determined that no such gain was realized.

III.

Venue

Petitioner filed its Federal income tax return for the taxable year ended September 30, 1947, with the

collector of Internal Revenue for the Sixth District of California. Accordingly, petitioner seeks a review of said decision of The Tax Court of the United States by the United States Court of Appeals for the Ninth Circuit.

Wherefore, your petitioner prays that this Court review said decision of The Tax Court of the United States, reverse the same, and issue such order or orders as may be proper in the premises.

Dated: August 21, 1953.

Respectfully submitted,

/s/ AUSTIN H. PECK, JR.,

/s/ HENRY C. DIEHL,

Attorneys for Petitioner.

Of Counsel:

LATHAM & WATKINS.

Received and filed August 21, 1953.

[Title of Court of Appeals and Cause.]

NOTICE OF FILING OF PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES

To the Commissioner of Internal Revenue, Washington, D. C.:

You are hereby notified that petitioner in the above-entitled proceeding in The Tax Court of the United States has filed, concurrently herewith, its petition to the United States Court of Appeals for the Ninth Circuit for review of the decision of The

Tax Court in said proceeding. A copy of said petition for review, together with this notice, are hereby served on you..

Dated: August 21, 1953.

/s/ AUSTIN H. PECK, JR.,
/s/ HENRY C. DIEHL,
Attorneys for Petitioner.

Of Counsel:
LATHAM & WATKINS.

Acknowledgment of Service

Service of the above Notice of Filing of Petition for Review, together with a copy of said Petition for Review, is hereby acknowledged this 21st day of August, 1953.

/s/ [Indistinguishable.]
Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

Received and filed August 21, 1953, T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 15, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the "Designation as to Contents of Record on Review and Statement of Points" and the "Counter Designation of

Contents of Record on Review" in the proceeding before The Tax Court of The United States entitled "Seaboard Finance Company, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket No. 30554" and in which the petitioner in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of October, 1953.

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States.

[Endorsed]: No. 14,095. United States Court of Appeals for the Ninth Circuit. Seaboard Finance Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed October 23, 1953.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit
Docket No. 14,095

SEABOARD FINANCE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS ON WHICH PETITIONER INTENDS TO RELY

(1) The Tax Court erred in entering decision for the respondent.

(2) The Tax Court erred in not entering decision for petitioner.

(3) The Tax Court erred in its finding that petitioner's use of foreign exchange in the purchase of the stock of Campbell Finance Corporation, Ltd., in accordance with the obligations incurred under the contract of March 27, 1946, did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of the Campbell Finance Corporation, Ltd., stock.

(4) The Tax Court erred in its conclusion that the respondent properly eliminated the gain on foreign exchange reported by petitioner in its return for the taxable year involved.

(5) The Tax Court erred in its finding that the 100,000 shares of capital stock of petitioner issued to Industrial Acceptance Corporation, Ltd., were deposited as security.

(6) The Tax Court erred in its conclusion that the cost to petitioner of the 50,000 shares of stock of Campbell Finance Corporation, Ltd., was $2,214,-969.94 (Canadian), converted into United States dollars at the rate of exchange prevailing on March 27, 1946.

(7) The Tax Court erred in its conclusion that any gain on the purchase and sale of Canadian dollars in this proceeding was offset by a loss sustained between the purchase price of the stock of Campbell Finance Corporation, Ltd., converted into dollars at the date of purchase, and the amount of American dollars required to purchase the same number of Canadian dollars when payment was subsequently made.

(8) The Tax Court erred in its conclusion that petitioner could and should have determined its cost of the Campbell Finance Corporation, Ltd., stock as of March 27, 1946.

Dated: October 29, 1953.

Respectfully submitted,
/s/ DANA LATHAM,
/s/ AUTIN H. PECK, JR.,
/s/ HENRY C. DIEHL,
Attorneys for Petitioner.

Affidavit of service by mail attached.

[Endorsed]: Filed October 30, 1953.

No. 14095

IN THE

United States Court of Appeals For the Ninth Circuit

SEABOARD FINANCE COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of the United States

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BRIEF AND APPENDIX FOR THE RESPONDENT

H. BRIAN HOLLAND
Assistant Attorney General

ELLIS N. SLACK
GEORGE F. LYNCH
Special Assistants to the Attorney General

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CITATIONS

IN THE

United States Court of Appeals For the Ninth Circuit

No. 14095

SEABOARD FINANCE COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

On Petition for Review of the Decision of the Tax Court of the United States

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BRIEF AND APPENDIX FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 20-48) are reported at 20 T.C. 405.

JURISDICTION

The petition for review (R. 72-74) involves a deficiency in corporate income tax for the taxable year ended September 30, 1947 in the amount of $70,590.74. A notice of deficiency was mailed to taxpayer on June

28, 1950. (R. 6, 11, 16.) Taxpayer filed a petition for redetermination with the Tax Court on September 15, 1950 (R. 3), under the provisions of Section 272 of the Internal Revenue Code. The decision of the Tax Court was entered on May 21, 1953, and served on May 22, 1953. (R. 5, 49.) The case is brought to this Court by a petition for review filed August 21, 1953. (R. 5, 72-74.) Jurisdiction of this Court is invoked under the provisions of Section 1141(a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether the purchase and commitment in March, 1946, of Canadian dollars in an amount equal to the purchase price of the Campbell stock, which was fixed in terms of Canadian dollars, constituted a transaction in foreign exchange requiring recognition of taxable gain separate and apart from the subsequent sale of the stock, where the Canadian dollars increased in value in terms of the American dollar between the date of the purchase of the stock and the date of payment therefor.

STATUTE INVOLVED

Internal Revenue Code:

> Sec. 22. Gross Income.
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> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * interest, rent, dividends, securities, or the transaction of any business carried on for gain or

profit, or gains or profits and income derived from any source whatever. * * *

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(26 U.S.C. 1946 ed., Sec. 22.)

STATEMENT

The facts, most of which were stipulated, as found by the Tax Court (R. 21-44), may be summarized as follows:

In December 1945, and the early part of 1946, taxpayer, a domestic corporation, engaged in the small loan business, entered into negotiations with Industrial Acceptance Corporation, Limited, a Canadian corporation, hereinafter called Industrial, for the purchase of the capital stock of the Campbell Finance Corporation, Limited, hereinafter called Campbell, a Canadian corporation, engaged in the small loan business in Canada. On January 2, 1946, the capital stock of Campbell consisted of 50,000 shares of common stock all of which was owned by Industrial. (R. 21-23.)

Industrial offered to sell the Campbell stock to taxpayer for a price equal to the net worth of Campbell, according to its books, plus $1,000,000. In terms of Canadian dollars, Industrial's asking price for the Campbell stock was $2,214,969.94, cash. (R. 23, 32.) Since it did not have sufficient cash resources, either in capital or ability to borrow, and since it could not pay the cash price and still have funds available with which to finance the operations of Campbell, taxpayer was unable to meet the terms of this offer, except through utilization of the method proposed by tax-

payer and incorporated in a written agreement entered into on March 27, 1946, but effective as of January 2, 1946. (R. 23-24.)

The funds required by taxpayer in order to carry on its activities were derived from three sources: (a) equity capital, consisting of preferred and common stock; (b) bonds or debentures; and (c) money borrowed from banks. In 1946 the banks with which taxpayer did business limited the total amount of unsecured loans to taxpayer at any time to twice taxpayer's equity capital, including as equity capital for this purpose all subordinated obligations. (R. 32.) As a consequence, taxpayer could not borrow the amount of the purchase price of the Campbell stock without upsetting the ratio of equity to borrowed capital which it had to maintain under its credit management with the banks. (R. 32-33.) In order to maintain the required ratio of equity to borrowed capital and at the same time obtain the money with which to meet the terms of the offer, the parties agreed that the purchase of the stock should be accomplished as follows (R. 24-32): the agreed price to be paid for the Campbell stock was $2,214,696.94 (Canadian currency); immediately following the execution of the agreement Industrial was to deliver to taxpayer the 50,000 shares of Campbell stock; taxpayer was to issue to Industrial 100,000 shares of its authorized common stock and deliver the same to the Canadian Bank of Commerce, in escrow; taxpayer was to submit to the Securities and Exchange Commission a registration statement covering the 100,000 shares of stock; taxpayer was to arrange with brokers to sell the 100,000 shares, and from the pro-

ceeds of such sale Industrial was to receive $2,214,969-.94—any deficiency to be made up by taxpayer, and any excess to be paid to taxpayer; interest was to be charged upon the purchase price from January 2, 1946, to the date of receipt of the full amount thereof by Industrial at the rate of 4½ per centum per annum, but dividends received by Industrial upon the 100,000 shares were to be credited against the interest; default date was set at November 30, 1946; in order to protect and indemnify Industrial against any loss that might arise from the taxpayer's election to repurchase its 100,000 shares prior to their sale, or from its failure to pay the full purchase price together with interest, taxpayer was to deposit with Industrial cash collateral of $2,200,000 on which Industrial was to credit interest at the rate of 4½ per centum to taxpayer's account while on deposit; Industrial could use any part of the collateral to supply any deficiency in purchase price, resulting from sale of the 100,000 shares of taxpayer's stock; the payment, deposit, exchange, adjustment or distribution of money involved under the agreement was to be in Canadian funds in the City of Montreal, except that in the event the sale of the 100,000 shares resulted in an excess over and above that to which Industrial was entitled, such excess was to be paid to taxpayer in whatever funds or currency the excess existed.

At the time that the negotiations for acquisition of the Campbell stock were being carried on, taxpayer had a line of credit with the bank of Manhattan Company in the amount of $2,000,000 (United States), and that bank was willing to loan taxpayer that amount for

use in connection with the agreement of March 27, 1946. (R. 34.)

On March 27, 1946, taxpayer through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares of its common stock in the name of Industrial, and caused that stock to be delivered to the Canadian Bank of Commerce, to be held in escrow. From and after the date of issuance, Industrial appeared on the stock transfer records and on the share register of taxpayer as the owner of 100,000 shares of the common stock of taxpayer. (R. 34.)

On January 28, 1946, prior to the issuance of the 100,000 shares of taxpayer's stock to Industrial, taxpayer's counsel sent a letter to the Securities and Exchange Commission, reciting in part that taxpayer believed it would be enabled to purchase a Canadian finance company on the basis of issuing in payment therefor certain shares of its common stock on condition that it would guarantee to the seller (Industrial) that it could find a purchaser to distribute the stock to the public within the ensuing seven or eight months; that the issued shares were to be held in escrow with a bank until such time as a registration statement was in effect; that the financing of the purchase contemplated the sale of the shares through an underwriter for the purpose of providing additional capital to taxpayer; and that unless the transaction was handled in the form of the issuance of stock in payment for the property, taxpayer would be required to issue a note or other paper obligation which would show up on its balance sheet as a quick liability, thus defeating somewhat the purpose of the transaction, whereas the is-

suance of stock with a contingent liability only to find an underwriter would not adversely affect taxpayer's balance sheet. In response to the question asked relative to the proposed method of financing the purchase, a member of the Securities and Exchange Commission replied by letter dated February 6, 1946, that he would not be inclined to raise any objection to the postponement of registration until such time as the offering to the public occurred. (R. 34-37.)

On March 27, 1946, Industrial caused to be transferred and delivered to taxpayer a certificate or certificates evidencing 50,000 shares of the common stock of Campbell. Thereafter, and until taxpayer sold the Campbell stock, taxpayer appeared on the stock transfer records and the share register of Campbell as the owner of the 50,000 shares which constituted all of Campbell's capital stock. (R. 37.)

On or about March 30, 1946, taxpayer issued its check to the Canadian Bank of Commerce in the amount of $2,000,000 United States dollars, with instructions to buy $2,200,000 in Canadian dollars for taxpayer's account. The Canadian dollars so purchased were deposited with Industrial pursuant to the agreement of March 27, 1946. Industrial acknowledged receipt of the deposit. The $2,000,000 United States dollars were borrowed by taxpayer from the Bank of Manhattan Company. (R. 37.)

On August 29, 1946, taxpayer filed a registration statement (which became effective on November 22, 1946) with the Securities and Exchange Commission registering 50,000 shares of series A cumulative preferred stock and 200,000 shares of common stock. The

prospectus which was prepared and filed as part of the registration statement recited in part that under the terms of the purchase and sale agreement, taxpayer had issued, in payment for all the 50,000 outstanding shares of common stock of Campbell, 100,000 shares of its common stock, which shares had been deposited in escrow with the Canadian Bank of Commerce pending the completion of arrangements by taxpayer with investment bankers for the public sale of the 100,000 shares for the account of Industrial and the registration of that stock. (R. 38.)

Under date of November 22, 1946, taxpayer and Industrial entered into an agreement with an underwriting firm pertaining to the shares registered as described above. That agreement provided in part that taxpayer proposed to issue and sell an aggregate of 100,000 shares of common stock of the par value of $1 each, and Industrial proposed to sell an aggregate of 100,000 shares of outstanding common stock of the par value of $1 each of the taxpayer. (R. 39.)

Of the 200,000 shares of common stock registered, 100,000 shares, constituting those shares which had been issued to Industrial by taxpayer, were offered for sale to the public on or about November 22, 1946. The net proceeds from the sale thereof was $1,440,000. (R. 40.)

The agreement between taxpayer and Industrial was concluded in accordance with the terms of a letter dated November 30, 1946, whereby Industrial authorized the bankers to pay taxpayer the net proceeds of the sale ($1,440,000), and taxpayer authorized Industrial to charge against the $2,200,000 collateral deposit

held by it an amount equal to the net proceeds from the sale of the stock and to deduct the balance of the purchase price from that deposit. (R. 40-41.)[1]

On March 27, 1946, and April 1, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was .9090. In November and December, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was par, less one-half of 1 per cent on conversion, or an effective ratio of .995, which had been in effect since July 5, 1946. (R. 42.) Applying this exchange ratio, taxpayer computed and reported in its income tax return for the year ended September 30, 1947, a long-term capital gain of $189,000 (United States dollars) which it designated as "Conversion gain on $2,000,000.00 deposit." (R. 14.) This computation was based on the fact that on November 30, 1946, when taxpayer authorized Industrial to apply the cash deposit against the purchase price of the Campbell stock, the $2,200,000 (Canadian) had a value of $2,189,000 (United States) as compared with a value of $2,000,000 (United States) in March, 1946, when the Canadian dollars were purchased. (R. 42, 45.) Taxpayer treated the gain so computed as resulting from a transaction in foreign exchange and as having taken place in Canada and took it into account in computing the credit to which it was entitled on ac-

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[1] As the Tax Court pointed out (R. 46-47) there is a difference of $14,969.94 (Canadian) not accounted for by these transactions. Since the record failed to show in what manner it was discharged or at what point the complicated accounts between taxpayer and Industrial took it into effect, the Tax Court disregarded that "comparatively small element" both for failure of proof and because it appeared not to be in controversy.

count of income taxes paid to the Dominion of Canada. (R. 9, 17, 45.) The effect was to increase the proportion taxpayer's income from sources within Canada to its income from all sources, and thus increase the amount of the credit allowable under Section 131 of the Internal Revenue Code. The Commissioner determined that no taxable gain resulted in connection with the transaction whereby the Campbell stock was purchased and accordingly eliminated the reported gain from taxpayer's income for the taxable year. (R. 14.)

In addition to the facts set forth above, the Tax Court found (R. 44) that Industrial did not want to become, and did not intend to become, a stockholder of taxpayer; that taxpayer did not want Industrial to become a stockholder; that taxpayer was not a dealer, trader, speculator, or investor in foreign exchange; that taxpayer sold all of its Campbell stock on December 31, 1946, and concluded (R. 44) that

> Petitioner's [taxpayer's] use of foreign exchange in the purchase of the Campbell stock, in accordance with obligations incurred under the purchase contract of March 27, 1946, did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of the stock.

The Tax Court also found that the Commissioner had properly eliminated the gain on foreign exchange reported by taxpayer in its return for the taxable year involved.

SUMMARY OF ARGUMENT

By an agreement dated March 27, 1946, taxpayer agreed to purchase the stock of a Canadian corporation for a fixed price in terms of Canadian dollars. Since Industrial, the owner of that stock, wanted payment in cash, and since taxpayer did not have sufficient resources either in cash or ability to borrow, it was agreed that the cash payment demanded could be effected by the method provided in the agreement.

Accordingly, the agreement provided, in form, that taxpayer would issue 100,000 shares of its own stock to Industrial, ostensibly in exchange for the 50,000 shares of Campbell, the Canadian corporation; that it would simultaneously deposit with Industrial, as security for the payment of the agreed purchase price, a covering amount ($2,200,000) in Canadian dollars; that it would undertake to sell the 100,000 shares of stock which it issued, guaranteeing to pay Industrial any deficiency in the event the proceeds from such sale were insufficient to meet the agreed purchase price of the Campbell stock.

Since taxpayer's ability to borrow was limited to twice its equity capital, it was only as a result of its issuance of the 100,000 shares, that it was able to borrow the sum of $2,200,000 (U.S.) which it used to purchase the collateral deposit of $2,200,000 (Canadian) which it was required to make.

Subsequently, in November, 1946, the proceeds from the sale of the 100,000 shares having netted less than the amount of the agreed purchase price, taxpayer authorized Industrial to apply the deposit of $2,200,000

(Canadian) in payment of the agreed purchase price, the proceeds of the sale of the 100,000 shares being credited to the account of the taxpayer.

Since the cost of the Campbell stock was to be determined in terms of the exchange rate prevailing on the date of its purchase, March 27, 1946, and since, under the terms of the agreement, the $2,200,000 (U.S.) was, on that date, committed, in terms of Canadian dollars, to the agreed purchase price of that stock, any subsequent increase in the Canadian exchange rate could not serve to increase the purchasing power of the $2,000,000 (U.S.). Under these circumstances, the Tax Court correctly found that taxpayer's use of foreign exchange in the purchase of the Campbell stock did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of that stock.

ARGUMENT

The Tax Court Correctly Determined That Taxpayer's Use of Foreign Exchange in the Purchase of the Campbell Stock, in Accordance With Obligations Incurred Under the Purchase Agreement of March 27, 1946, Did Not Constitute a Transaction in Foreign Exchange Requiring Recognition of a Taxable Gain Separate and Apart From Subsequent Sale of the Stock

It is clear from the terms of the agreement of March 27, 1946, (R. 24-32), that taxpayer agreed to purchase from Industrial the 50,000 shares of Campbell stock at a fixed price, in terms of Canadian dollars, of $2,214,969.94. Taxpayer's assertions that the Tax Court erred in finding to that effect (Br. 13, 20) ignore the plain language of the agreement as well as the stipu-

lated facts (Appendix, *infra*).[2] Thus, the many references in the agreement (R. 25, 27, 29, 30, 31, 39, 43), which clearly show that the agreed purchase price for the Campbell stock was $2,214,969.94, find specific confirmation in the stipulated facts which provide in part that (Stip. par. 10):

> At the time of the execution of the agreement * * * [taxpayer] was not in a position to pay out cash in the amount specified in the agreement ($2,214,969.94 Canadian) for the Campbell stock.

It is not true, therefore, as taxpayer asserts (Br. 21) that all it paid or agreed to pay on March 27, 1946, for the Campbell stock was 100,000 shares of its own common stock. The issuance of those 100,000 shares of stock to Industrial, purportedly in exchange for the 50,000 shares of Campbell stock, was necessitated by the fact that Industrial wanted payment in cash (R. 23, 53-54, 71), and taxpayer did not have sufficient cash resources, either in capital or ability to borrow, with which to meet Industrial's asking price in cash (R. 23; Stip. par. 10). Since taxpayer's borrowing capacity was limited to twice its equity capital (R. 32), it was necessary, in order to finance the purchase, that taxpayer increase its equity capital, so that its ratio of borrowed to equity capital would be maintained within

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[2] Although the Stipulation of Facts was not printed as part of the printed record on this appeal, it now appears that particular parts of the language therein are necessary for a proper consideration of this case. Accordingly the Commissioner has printed the stipulation as an appendix to this brief, and by appropriate motion accompanying this brief requests this Court to accept such stipulation as part of the printed record herein.

the limits imposed by the banks with which it was doing business (Stip. par. 10). At the time the negotiations for the purchase were being carried on, taxpayer had a line of credit in the amount of $2,000,000 (U.S.) with the Bank of Manhattan which was willing to loan that amount to taxpayer for use in connection with the agreement to purchase the Campbell stock. (Stip. par. 10.)

Although Industrial wanted cash (R. 23, 53), not stock (R. 44) in payment for the Campbell stock, it was willing to go along with the proposed issue of 100,000 shares of the taxpayer's stock as a means of financing the purchase, provided taxpayer, while undertaking to sell those shares for the account of Industrial, would guarantee to Industrial payment of the stipulated cash price, in Canadian dollars, agreed upon. Accordingly, under the contract, the agreed price for the Campbell shares was to be paid from the proceeds of a public sale of the 100,000 shares to be issued by taxpayer, with any deficiency to be made good either from the issuance and sale of additional shares, or by payment in cash. (R. 25.) In order to guarantee full payment of the agreed purchase price of $2,214,969.94 (Canadian) to Industrial, it was agreed that concurrently with the transfer and delivery of the 50,000 shares of Campbell stock to it, taxpayer would deposit with Industrial as cash collateral security the sum of $2,200,000 in Canadian currency.[3] (R. 29-30; Stip. par. 15.) It was only by utilization of this method that taxpayer was able to meet Industrial's demand that the payment of the purchase price be made in cash. (R. 23, 32.)

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[3] See footnote 1.

Coincident with the issuance of the 100,000 shares of its stock to Industrial, taxpayer issued its check to the Canadian Bank of Commerce in the amount of $2,000,000 (U.S.) with instructions to buy $2,200,000 (Canadian) for its account, the money having been borrowed from the Bank of Manhattan. (R. 37, 45; Stip. par. 14, 15.) Canadian dollars in the required amount were purchased and deposited with Industrial pursuant to the terms of the agreement. (R. 37.) Thus, in March, 1946, payment of the agreed purchase price of $2,214,969.94 in Canadian dollars was assured.

By the end of November, 1946, when the 100,000 shares had been sold, the proceeds amounted to $1,440,000, netting $14.40 per share, which was the approximate market value of the stock during the time the agreement to purchase was being negotiated. (R. 33, 40, 41.) On November 30, 1946, taxpayer authorized Industrial to apply the cash deposit of $2,200,000 (Canadian) against the purchase price of the Campbell stock, with instructions to it to cause the 100,000 shares of stock, which had been held in escrow pending the filing of a registration statement with the Securities and Exchange Commission,[4] to be delivered to the

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[4] Taxpayer seeks to capitalize (Br. 13-15) on the statement in the Tax Court's opinion (R. 45) that "As security * * * [taxpayer] was required to deposit in escrow $2,200,000 Canadian, as well as the shares of its stock, pending the completion of the details of sale." Although that sentence is in part a misstatement of the stipulated facts in that the $2,200,000 was not deposited "in escrow", and the shares of stock were not deposited as "security" for the purchase price, nevertheless, it is clear that such misstatement was only that and not an interpretation of the facts leading to reversible error, and it does not appear to us that taxpayer contends otherwise.

brokers with instructions to them to credit the proceeds of the sale of those shares to taxpayer's account. (R. 41.) At that time, the deposit of $2,200,000 (Canadian) had a value, based upon the Canadian exchange rate then prevailing, of $2,189,000 (U.S.). (R. 42, 45.) Ignoring the fact that the purchase money had already been converted to Canadian dollars in March, and at that time applied to the purchase, taxpayer made a computation based upon the erroneous assumption that payment had been made at the exchange rate prevailing in November or December 1946, thus attempting to show a gain of $189,000 (U.S.) This was done on the theory that it required that much less in American money to meet the agreed purchase price in November or December, than was required in March, when the Canadian dollars were purchased. Such, however, was not the fact.

It is axiomatic that taxation is an intensely practical matter, concerned with economic realities and that tax consequences flow from the substance of a transaction rather than from the form in which it is cast. *Commissioner* v. *Court Holding Co.,* 324 U.S. 331; *Bowers* v. *Kerbaugh-Empire Co.,* 271 U.S. 170, 174. In the instant case, as has been pointed out, the purchase price of the Campbell stock had been fixed in March, 1946, at $2,214,969.94 in terms of Canadian dollars. At the same time, taxpayer purchased a covering amount of Canadian dollars which it deposited with Industrial, as required by the agreement, thus in reality effecting payment for the Campbell stock at that time. Since the deposited purchase money was thus appropriated to the fixed contract price, both expressed in Canadian

dollars, no fluctuation upward in the Canadian exchange rate after March, 1946, could produce any economic gain to taxpayer in terms of the purchasing power of the $2,000,000 (U.S.) which it had expended, much less taxable consequences. With cost basis of the Campbell stock established and the purchasing power of the $2,000,000 (U.S.), pegged, in terms of Canadian dollars, to that fixed and agreed purchase price, the foreign exchange aspects of the instant transaction were stabilized for federal income tax purposes. Thereafter any fluctuations upward in the Canadian exchange rate could have no effect on the purchasing power of the $2,000,000 (U.S.) since the fixed purchase price of the Campbell stock in terms of Canadian dollars and the value of the Canadian dollar would move upward together.

It is clear, then, that the purchase and application of the foreign exchange (Canadian dollars) was by the terms of the contract itself, a fixed and integral part of the purchase of the Campbell stock. The fact that the payment of the agreed purchase price and the covering deposit were required in Canadian dollars effectively precluded any speculation in foreign exchange in connection with the purchase of the Campbell stock. Taxpayer, however, seeks to show a separate transaction in foreign exchange by contending (Br. 15-19) that it entered into a "speculative agreement" for the purchaase of 50,000 shares of Campbell stock. While taxpayer may have been speculating with respect to whether or not the proposed sale of the 100,000 shares of stock which it issued would produce the amount of the agreed purchase price, that aspect of

the transaction did not have, and could not have, any bearing on the foreign exchange aspects of the transaction, which, as pointed out, had already been fixed and determined in March, 1946, coincident with the purchase and delivery of the Campbell stock. Thereafter, any increase in the value of the 100,000 shares of stock issued by taxpayer would only serve to decrease the amount of any deficiency which taxpayer would have to pay in the event the proceeds from their sale proved to be less than the amount of the agreed purchase price of the Campbell stock. Any increase in the value of those shares could not, however, affect the purchasing power of the $2,000,000 (U.S.) which, in terms of converted Canadian dollars, had already been committed to the purchase of the Campbell stock on March 27, 1946.

As the Tax Court pointed out (R. 46), the cost of the Campbell shares was to be determined at the rate of exchange prevailing at the date of purchase, March 27, 1946, and not, as taxpayer contends (Br. 11), on the date of actual payment, in November or December. See *Bernuth Lembcke Co.* v. *Commissioner,* 1 B.T.A. 1051 (Acquiescence, IV-2 Cum. Bull. 3), and *Joyce-Koebel Co.* v. *Commissioner,* 6 B.T.A. 403 (Acquiescence, VI-2 Cum. Bull. 4).[5] Here the price of the

[5] Taxpayer's position in this regard is based upon a ruling of the Commissioner published as O.D. 489, 2 Cum. Bull. 60 (1920). It appears, however, that the acquiescences entered by the Commissioner with respect to the *Bernuth-Lembcke* and *Joyce-Koebel* cases, which were decided at a later date, indicated the Commissioner's abandonment of O.D. 489, and acceptance of the date of purchase as the controlling date for determining the cost of a commodity purchased with foreign exchange.

Campbell stock was fixed in Canadian dollars by the terms of the agreement and cash was placed in the seller's (Industrial's) hands at the inception of the agreement. When final payment was effected some eight or nine months later, the purchase price, expressed in terms of Canadian dollars, was still the same. Under these circumstances it is inconceivable that because there was a difference in the exchange ratio between the American and Canadian currencies on the two dates, foreign exchange gain can be spelled out of the purchase of the Campbell stock. As taxpayer, itself, recognizes (Br. 11-12) there must be a conversion of the foreign currency in order that gain or loss may be deemed to have been realized. The only conversion which took place in the instant case, however, occurred in March, 1946, when the Canadian dollars were purchased and committed to the purchase of the Campbell stock in accordance with the terms of the agreement. On or after November 30, 1946, when taxpayer authorized application of the deposited Canadian dollars against the agreed purchase price, there was no conversion of the sum deposited back to United States dollars or another purchase of $2,214,-969.94 (Canadian) at the exchange rate then in effect in order to consummate the transaction. Rather, at that time, Industrial merely authorized the underwriters to pay the proceeds of the sale of the 100,000 shares of stock to taxpayer in United States dollars, while at the same time crediting the deposited Canadian dollars against the agreed purchase price. Under these circumstances, it requires a very strained and artificial interpretation of this purchase agreement to derive from it

a separate transaction in foreign exchange resulting in a gain, separate and apart from the purchase of the Campbell stock. The comment of the court in *Commissioner* v. *Ashland Oil & R. Co.,* 99 F. 2d 588 (C.A. 6th), would appear to be in point; there it was stated in part (p. 591):

> And without regard to whether the result is imposition or relief from the taxation, the courts have recognized that where the essential nature of a transaction is the acquisition of property, it will be viewed as a whole, and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority.

The case of *Bernuth Lembcke, supra,* cited by the taxpayer (Br. 12), supports the position of the Commissioner rather than that of the taxpayer. We have already cited that case for the proposition that where property is purchased at a price expressed in foreign currency, the cost of the property should be entered at the exchange rate, in terms of American currency, prevailing at the date of purchase, not the rate at the date of payment. Examination of that case also shows, that the foreign exchange (pounds sterling) which was used to purchase the creosote oil were purchased independently of the oil purchase, and that at the time of the purchase of the pounds sterling taxpayer had no fixed obligation expressed in pounds sterling with respect to the creosote oil. At the time he later incurred such a fixed obligation in terms of pounds sterling, upon his purchase of creosote oil, the purchasing power of the pound in terms of American dollars had declined as a

result of an intervening fluctuation downward in the exchange rate. Accordingly, the Board of Tax Appeals correctly found, on the basis that the transactions was separate and distinct, that a tax loss had been sustained.

The *Joyce-Koebel* case, *supra,* also cited by taxpayer (Br. 12), merely stands for the same basic principle as the *Bernuth Lembcke* case, *supra.* In that case, however, the Board of Tax Appeals recognized that since taxpayer therein was speculating or investing in foreign exchange by virture of the fact that he purchased credit expressed in terms of pounds sterling, rather than making payment at the time of purchase, any gain or loss from the fluctuation of the foreign currency was to be accounted for as a separate transaction. As has been pointed out, the instant case did not involve a speculation or investment in foreign exchange.

Neither does the case of *Credit & Investment Corp.* v. *Commissioner,* 47 B.T.A 673, which taxpayer also relies on (Br. 12), require any different result from that for which we here contend. In that case, the taxpayer, an American corporation, purchased a bond of a German corporation, payable in dollars. In 1935, taxpayer received payment for the balance due on its bond in blocked marks, and shortly thereafter invested a portion of those marks in other German securities which it sold during the taxable year, receiving blocked marks which it immediately converted into dollars. The Board of Tax Appeals held that a completed transaction resulted from the payment in blocked marks in 1935 of the bond which taxpayer had acquired in 1926,

and that the investment of a portion of the blocked marks in German securities was a separate and distinct transaction, so that when taxpayer sold the securities it sustained a loss measured by the difference between the value in dollars of the blocked marks at the time of purchase and the amount realized from the sale.

Taxpayer also quotes (Br. 23-24) from the concurring opinion of Judge Opper in *Willard Helburn, Inc.* v. *Commissioner,* 20 T.C. No. 106, to the effect that since a collateral transaction in foreign exchange "may be involved" in the purchase of a particular commodity, the full scope of a taxpayer's gain or loss will not be given effect in his tax liability unless the foreign exchange transaction is also dealt with. Taxpayer's complaint in this respect must fall of its own weight for the Tax Court's conclusion that there was no gain on the foreign exchange aspect of the instant transaction separate and apart from the subsequent sale of the Campbell stock was made only after giving full effect to the foreign exchange feature of the transaction with the resulting determination that it constituted an integral part of the purchase arrangement, having no separate and distinct tax consequences.

Taxpayer's further argument (Br. 19-23) that it could not determine the cost of the Campbell stock on March 27, 1946, the purchase date, is also without merit, and stems from its refusal to accept the fact, demonstrated above, that the agreed purchase price for that stock was $2,214,969.94 (Canadian). Since under the doctrine of the *Bernuth Lembcke* and *Joyce-Koebel* cases, the cost of the Campbell stock was to be

determined in terms of the exchange rate prevailing on the date of purchase, March 27, 1946, its cost in terms of American dollars could easily have been determined, as the Tax Court pointed out (R. 47-48), by the mere mathematical process of converting the $2,214,969.94 (Canadian) into American dollars at the then prevailing rate of exchange.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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February, 1954

APPENDIX

THE TAX COURT OF THE UNITED STATES

Docket No. 30554

SEABOARD FINANCE COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Stipulation of Facts

Petitioner and respondent, through their respective counsel, hereby stipulate that the following facts are true and may be received by the Court in this proceeding, reserving, however, to each party the right to object to any such facts on the ground of materiality or relevance, and the further right to introduce other or further evidence not inconsistent herewith:

(1) Petitioner is a corporation organized and existing under the laws of the State of Delaware. Its principal business office is located at 945 S. Flower Street, Los Angeles 15, California. Its books and records are maintained on the basis of a fiscal year ending September 30 of each year. Its federal income tax return for the fiscal year ended September 30, 1947, was filed in the office of the Collector of Internal Revenue for the 6th District of California at Los Angeles, California.

(2) Petitioner is engaged in the small loan business. Said business consists of making secured and unsecured loans to necessitous borrowers, usually individuals. During the period here in question the average loan made by petitioner was $310.00.

(3) In 1946 Campbell Finance Corporation Limited (hereinafter called "Campbell") was a corporation organized and existing under the laws of the Province of Ontario, Dominion of Canada. It was then engaged in the small loan business in Canada, operating approximately 50 offices, with aggregate loans outstanding as of March 31, 1946 of approximately $5,965,802 (Canadian).

(4) In January, 1946, Campbell had 50,000 shares of common stock issued and outstanding, said shares being the only issued and outstanding shares of stock of said corporation. On and immediately prior to January 2, 1946, all of said shares of stock were owned by Industrial Acceptance Corporation Limited, a Canadian corporation (hereinafter called "Industrial").

(5) There is attached hereto as Exhibit "A-1" a copy of an agreement between Industrial and petitioner relating to the 50,000 shares of Campbell stock. There is attached hereto as Exhibit "B-2" a copy of a letter dated February 9, 1946, sent by petitioner to Industrial.

(6) Industrial's principal business is, and was, except for its ownership of Campbell stock, the discounting of commercial installment paper for Canadian dealers in automobiles, furniture, farm implements, and other property. It was not actively engaged in the small loan business as such except through its ownership of the Campbell stock. Industrial had acquired all of the Campbell stock in 1940, holding it until the end of World War II as a means of compensating for the decline in its regular business of discounting paper, said business having declined during the war period

because of shortage of automobiles and other equipment.

(7) In August, 1946, Industrial offered for sale to the public $2,000,000 of its 3½% Twenty-year Sinking Fund Debenture Series "A", and, under date of August 26, 1946, circulated a prospectus relating to said offer. Said prospectus contained the following statement relative to Campbell Finance Corporation Limited:

> "In 1940 when it became evident that the manufacture of automobiles, radios, refrigerators and other durable consumer goods would be curtailed for the duration of the war the Company purchased all of the capital stock of Campbell Finance Corporation Limited (then known as Campbell Auto Finance Company Limited) in order to provide another avenue for the employment of the Company's resources. The business of Campbell Finance Corporation Limited consisted principally of making small loans under the Dominion Small Loans Act 1939 and operated from its head office in Toronto as well as three branches in the Province of Ontario. Facilities available through the countrywide network of branches of Industrial Acceptance Corporation Limited made it possible to develop a very substantial and profitable small loans business during the intervening years, thus materially assisting the company to maintain its branch organization and earnings.
>
> "With the prospect of the return of instalment sales financing in larger volume than has been en-

joyed by the Company in the past, the Directors entered into an agreement with Seaboard Finance Company, one of the larger personal loan companies in the United States, for the sale of all of the shares of Campbell Finance Corporation Limited as at January 2nd, 1946, at a price which gives Industrial Acceptance Corporation Limited a very substantial profit on its investment. As a result of this agreement the Company will withdraw from the small loans field and will have available for its regular instalment sales finance business all of the capital employed in that business before the war, plus the profit realized. The Company has received 100,000 shares of the common stock of Seaboard Finance Company and the latter has undertaken to arrange for the sale of these shares on or before November 30th, 1946, and has guaranteed to Industrial Acceptance Corporation Limited the receipt of $2,214,970. Until November 30th, 1946, Seaboard Finance Company may be relieved of this guarantee by returning the shares of Campbell Finance Corporation Limited and making payment of substantial sums of cash to Industrial Acceptance Corporation Limited. Seaboard Finance Company has deposited with the Company cash collateral of $2,200,000 to guarantee the fulfillment of its obligations.''

(8) The funds required by petitioner in order to carry on its activities are and have been derived from three sources: (a) equity capital, consisting of preferred and common stock; (b) bonds or debentures;

and (c) money borrowed from banks. In 1946 the banks with which petitioner did business limited the total amount of unsecured loans to petitioner at any time to twice petitioner's equity capital, including as equity capital for this purpose all subordinated obligations.

(9) The following table discloses the ratios between petitioner's equity capital, including subordinated obligations, and loans from banks on the dates indicated:

Date	*Superior Indebtedness (Bank loans)*	*Equity Capital & Subordinated Obligations*	*Borrowing Ratio*	*Ratio had the 100,000 Seaboard shares not been issued to Industrial*
Jan. 31, 1946	$10,750,000	$ 7,089,157	1.5-1	
Feb. 28, 1946	11,250,000	7,386,673	1.5-1	
Mar. 31, 1946 Before execution of Exhibit "A-1"	13,079,366	7,999,228	1.6-1	
After execution of Exhibit "A-1"	17,729,366	9,249,228	1.9-1	2.2-1
June 30, 1946	22,625,000	10,790,427	2.1-1	2.5-1
Dec. 31, 1946 After Sale	21,842,500	12,106,238	1.8-1	2.0-1

(10) At the time of the execution of the agreement (Exhibit "A-1") petitioner was not in a position to pay out cash in the amount specified in the agreement ($2,214,969.94 Canadian) for the Campbell stock. It was decided that the acquisition of the Campbell stock would have to be accomplished through an issuance of additional shares of petitioner's stock, so that its ratio of borrowed to equity capital would be maintained within the limits imposed by the banks with whom petitioner was doing business. At the time that the negotiations for purchase were being carried on, petitioner had a line of credit with the Bank of the Manhattan Company in the amount of $2,000,000. The Bank of the Manhattan Company was willing to loan $2,000,000

(U.S.) to petitioner for its use in connection with the agreement between petitioner and Industrial (Exhibit "A-1").

(11) On March 27, 1946, petitioner, through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares of its common stock in the name of Industrial, and caused the same to be delivered to the Canadian Bank of Commerce, Toronto, Ontario, Canada, to be held in escrow. From and after said date of issuance Industrial appeared on the stock transfer records and on the share register of petitioner as the owner of 100,000 shares of common stock of petitioner. There is attached hereto as Exhibit "C-3" a copy of a letter from petitioner to The Canadian Bank of Commerce, dated April 2, 1946, relative to said 100,000 shares.

(12) On January 28, 1946, and prior to issuance of the 100,000 shares of petitioner's stock to Industrial, Bruce R. Tuttle, Esq., petitioner's counsel, sent a letter to the Securities and Exchange Commission, Washington. D. C., relative to the proposed issue. A copy of said letter is attached hereto as Exhibit "D-4".

(13) On February 6, 1946, Edward H. Cashion, Esq., counsel to the Securities and Exchange Commission, replied to Mr. Tuttle's letter of January 28, 1946. A copy of said reply is attached hereto as Exhibit "E-5".

(14) On March 27, 1946, Industrial caused to be transferred and delivered to petitioner a certificate or certificates evidencing 50,000 shares of the common stock of Campbell. From and after said date, and until petitioner sold said Campbell stock, petitioner ap-

peared on the stock transfer records and the share register of Campbell as the owner of said 50,000 shares, being all of Campbell's issued and outstanding capital stock.

(15) On or about March 30, 1946, petitioner issued its check to the Canadian Bank of Commerce, Toronto, in the amount of $2,000,000 (U.S.), with instructions to buy, for petitioner's account, $2,200,000 (Canadian). Canadian dollars in that amount were purchased for petitioner's account and deposited with Industrial pursuant to the provisions of the agreement, Exhibit "A-1". The $2,000,000 (U.S.) herein referred to was borrowed by petitioner from the Bank of the Manhattan Company. There is attached hereto as Exhibit "F-6" a true copy of the receipt given by Industrial for said deposit. There is attached hereto as Exhibit "G-7" a copy of a letter dated April 1, 1946, from the Canadian Bank of Commerce to petitioner.

(16) During the year 1946 the common stock of petitioner was not listed on any national securities exchange. It was, however, traded in the over-the-counter market. The over-the-counter quotations on the common stock of petitioner on the various dates indicated were as follows:

Date	*Bid*	*Ask*
1/9/46	14⅝	15⅜
1/15/46	14¼	15
3/1/46	13½	14½
3/15/46	13¾	14½
3/26/46	15¾	16½
3/27/46	16¼	17

Date	*Bid*	*Ask*
4/2/46	17¼	18
4/15/46	17¾	18½
4/30/46	18½	19½
5/15/46	18½	19¼
6/3/46	21	22
6/7/46	22	23
7/16/46	21½	22½
8/27/46	19¼	20¼
9/4/46	17	18
9/5/46	16½	17½
9/27/46	16¼	17¼
10/31/46	15½	16½
11/22/46	16¼	17¼

(17) On or about May 4, 1946, petitioner commenced the preparation of a registration statement for filing with the Securities and Exchange Commission, Washington, D. C. Said registration statement was filed on August 29, 1946, and became effective on November 22, 1946, and registered 50,000 shares of Series A Cumulative Preferred Stock and 200,000 shares of Common Stock. A prospectus was prepared and filed as a part of the registration statement. A copy of the prospectus is attached hereto as Exhibit "H-8".

(18) Under date of November 22, 1946, petitioner and Industrial entered into an underwriting agreement with Van Alystine, Noel & Co., Johnston, Lemon & Co., and Crowell, Weedom & Co., pertaining to the shares registered as above described. A copy of said underwriting agreement is attached hereto as Exhibit "I-9".

(19) Of the 200,000 shares of common stock registered as above described, 100,000 shares were offered for sale to the public on or about November 22, 1946. These shares were the shares which had been issued by petitioner in the name of Industrial, as described in paragraph (11) above.

(20) The net proceeds, after deduction of underwriting commissions, from the sale of said 100,000 shares of stock in petitioner were $1,440,000 (U.S.). On November 30, 1946, petitioner sent a letter to Industrial, a copy of which is attached hereto as Exhibit "J-10". The agreement (Exhibit "A-1") between petitioner and Industrial was concluded in accordance with said letter.

(21) There is attached hereto as Exhibit "K-11" a copy of a letter dated January 3, 1947, from Industrial to Messrs. Haskins & Sells, certified public accountants, to which is attached a copy of a statement prepared by Industrial. Of the items listed in said statement, interest due from Industrial to petitioner, losses guaranteed under the contract, and interest due from petitioner to Industrial (less application of dividends) were all settled by appropriate book adjustments. The dividends in the amount of $72,000 on the 100,000 shares of petitioner's common stock were actually paid in cash to Industrial. The net balance of $57,227.40 was actually paid in cash by Industrial. In addition to the foregoing items, petitioner received, as dividends from Campbell prior to December 31, 1946, $400,000. All of said amounts are expressed in Canadian dollars.

(22) On March 27, 1946, and April 1, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was .9090. In November and December, 1946, the official exchange ratio of the Canadian dollar to the United States dollar was par, less ½ of 1% on conversion, or an effective ratio of .995, which had been in effect since July 5, 1946.

(23) In its federal income tax return for the year ended September 30, 1947, petitioner claimed a credit for taxes paid to the Dominion of Canada in the amount $230,580.91. The statutory notice of deficiency determined that the credit should be $153,705.40, in lieu of the amount claimed by petitioner in its return.

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No. 14095.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SEABOARD FINANCE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S OPENING BRIEF.

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PETITIONER'S OPENING BRIEF.

Jurisdiction.

This petition for review involves federal income taxes of Seaboard Finance Company, a corporation, for the fiscal year ended September 30, 1947.

The Commissioner of Internal Revenue determined a deficiency in the federal income taxes of Seaboard Finance Company (hereinafter called "Seaboard") and mailed a notice of deficiency [R. 11-16]. Seaboard thereafter filed a petition [R. 5-16] with The Tax Court of the United States (hereinafter called the "Tax Court") pursuant to the provisions of Section 272 of the Internal Revenue Code (26 U. S. C. A., Sec. 272). The decision of the Tax Court was in favor of the Commissioner of Internal Revenue (20 T. C. ....., No. 54, 1953).

The petition for review was filed on or about August 21, 1953 [R. 72-74] pursuant to the provisions of Sec-

tions 1141 and 1142 of the Internal Revenue Code (26 U. S. C. A., Secs. 1141 and 1142).

Question Presented.

The question presented for adjudication in this proceeding is whether Seaboard realized a gain on foreign exchange in December, 1946, by virtue of the application of Canadian dollars, which had appreciated in value between the date of their purchase and the date of said application, on the purchase of property in Canada.

Statement of the Case.

Late in 1945, Seaboard, a Delaware corporation engaged in the small loan business in several states of the United States, learned that all of the issued and outstanding stock of Campbell Finance Corporation Limited (hereinafter called "Campbell") was available for purchase from its then owner, Industrial Acceptance Corporation Limited (hereinafter called "Industrial") [R. 52]. Both Industrial and Campbell were corporations organized and existing under the laws of Canada or a province thereof. Campbell was then engaged in the small loan business in Canada, operating approximately 50 offices. Campbell had 50,000 shares of common stock outstanding, these being the only issued and outstanding shares of stock of that corporation [R. 22].

In January or February, 1946 officers of Seaboard discussed with officers of Industrial the possibility of purchase by Seaboard of the Campbell stock. Industrial's asking price was approximately $2,214,969.94 (Canadian), which figure exceeded the net book value of Campbell's assets by approximately $1,000,000.00 [R. 52-53].

In the early months of 1946 Seaboard did not have sufficient cash resources, either in capital or ability to borrow, to meet Industrial's asking price in cash. In addition, the premium over net book value asked by Industrial was considered by Seaboard to be excessive [R. 54]. However, Seaboard desired to acquire the Campbell stock. Accordingly, Seaboard made an offer to Industrial to acquire the Campbell stock, the terms of which offer were embodied in an agreement dated March 27, 1946 [R. 53; 24-32]. By said agreement Industrial agreed forthwith to transfer and deliver the Campbell stock to Seaboard. Seaboard agreed contemporaneously to issue to Industrial 100,000 shares of Seaboard's then authorized but unissued common stock. Said shares were to be delivered to the Canadian Bank of Commerce [R. 24].

In addition, Seaboard agreed to proceed speedily with the preparation and submission to the United States Securities and Exchange Commission of a Registration Statement to cover said 100,000 shares so issued to Industrial, and to effect appropriate arrangements with investment bankers for the sale to said bankers, by Industrial, of the shares so issued by Seaboard to Industrial [R. 24-25]. Industrial was to be entitled to receive and retain from the sale to the investment bankers of said 100,000 shares of Seaboard stock $2,214,969.94 (Canadian). If the proceeds of sale of said 100,000 shares to the bankers were not equivalent to that figure, Seaboard guaranteed to make good the deficiency either by issuing and delivering to Industrial additional shares of Seaboard's common stock or by making a cash payment equal to the deficiency [R. 25].

Under the agreement of March 27, 1946 Seaboard could, under described circumstances, rescind the trans-

action and return the Campbell stock to Industrial. In such event Seaboard would be subject to described penalties [R. 27-29]. However, unrestricted possession of the Campbell stock was given to Seaboard, and it had the power to dispose of said shares, although it agreed not to do so. Therefore, the agreement contained a provision that, for the protection and indemnification of Industrial against any loss or damage that might or could arise from Seaboard's default under the agreement, Seaboard would deposit with Industrial, as cash collateral security, the sum of $2,200,000.00 (Canadian). Industrial agreed to pay interest to Seaboard at the rate of 4½% per annum on said funds so long as they should be on deposit as cash collateral [R. 29].

On March 27, 1946 Seaboard, through its stock transfer agent in New York City, issued, as an original issue, 100,000 shares in the name of Industrial and delivered them to the Canadian Bank of Commerce, Montreal. From and after said date Industrial appeared on the stock transfer records and the share register of Seaboard as the owner of 100,000 shares [R. 34]. On the same date Industrial delivered to Seaboard the 50,000 shares of Campbell stock; and thereafter Seaboard appeared on the stock transfer record and share register of Campbell as the owner of all of the Campbell stock [R. 37].

Included in the written stipulation filed by the parties in the Tax Court was a provision that the fair market value of the 100,000 shares of Seaboard stock issued to Industrial pursuant to the March 27, 1946 agreement was, on the date of issue, $12.50 per share, or an aggregate of $1,250,000.00. Seaboard's management believed that when news of the acquisition of the Campbell stock by Seaboard became known the market value of Seaboard's

stock would rise [R. 54; 33]. Seaboard hoped that the proceeds of the sale by Industrial to the investment bankers of the 100,000 shares of Seaboard stock would equal or exceed $2,214,969.94 (Canadian). In June, 1946 the over-the-counter quotations on Seaboard's common stock reached approximately $22.00 per share, which condition continued through the middle of July, 1946 [R. 55-56; 33-34]. Thereafter the market for Seaboard stock, in line with the general market, declined so that by November 22, 1946 the market quotations were approximately $17.00 per share [R. 34].

In May, 1946 Seaboard commenced the preparation of a Registration Statement. It was not filed until August 29, 1946, and became effective on November 22, 1946 [R. 38]. The preparation and filing of the Registration Statement were delayed because of problems encountered in the completion of an audit of Campbell and Seaboard [R. 39]. 100,000 shares of Seaboard stock were offered to the public through investment bankers on or about November 22, 1946. The net proceeds from the sale of the shares, after deduction for brokers' commissions, were $1,440,000.00 (United States). The shares so sold through the investment bankers were the shares which had been issued by Seaboard to Industrial [R. 39-40].

In settling the accounts between the parties Industrial, in November, 1946, authorized the investment bankers to pay to Seaboard the net proceeds of the sale of Industrial's shares ($1,440,000.00); and Seaboard authorized Industrial to apply the Canadian dollars which had been deposited as cash collateral security to the payment for the Campbell stock [R. 40-41].

In its United States income tax return for its fiscal year ended September 30, 1947 Seaboard reported a gain

on foreign exchange in the amount of $189,000.00. When Seaboard purchased the $2,200,000.00 (Canadian) for deposit as cash collateral security, a favorable rate of exchange existed which enabled Seaboard to acquire those Canadian dollars for only $2,000,000.00 (United States). In November, 1946, when Seaboard authorized Industrial to take the Canadian dollars, the Canadian dollar was virtually at parity with the United States dollar. As a result, the $2,200,000.00 (Canadian) were worth at that time $2,189,000.00 (United States) [R. 42].

Seaboard treated the gain on foreign exchange above described as a transaction which occurred in Canada. In computing its credit for Canadian income taxes under Section 131 of the Internal Revenue Code Seaboard included said $189,000.00 exchange gain as income from sources within Canada. By virtue of this action the proportion of Seaboard's income from sources within Canada to its income from all sources was increased; and such increase increased the amount of the permissible credit under Section 131 of the Internal Revenue Code.

Upon audit of Seaboard's income tax return the Commissioner of Internal Revenue (hereinafter called the "Commissioner") refused to recognize any gain on foreign exchange, and reduced Seaboard's Canadian income tax credit accordingly [R. 13-16]. The deficiency here in controversy results entirely from that action by the Commissioner.

Specification of Errors.

(1) The Tax Court erred in its ultimate finding, or conclusion, that Seaboard's use of foreign exchange in the purchase of Campbell stock did not constitute a transaction in foreign exchange requiring recognition of a tax-

able gain separate and apart from the subsequent sale of the Campbell stock.

(2) The Tax Court erred in its finding that the cost of the Campbell stock to Seaboard was $2,214,969.94 (Canadian) converted into United States dollars at the rate of exchange prevailing on March 27, 1946.

(3) The Tax Court erred in its finding, or conclusion, that Seaboard could and should have determined its cost of the Campbell stock as of March 27, 1946.

(4) The Tax Court erred in its finding that the 100,000 shares of Seaboard stock issued to Industrial were merely issued as security.

(5) The Tax Court erred in its conclusion that any gain on purchase and sale of Canadian dollars was offset by an equivalent loss measured by the difference between the purchase price of the Campbell stock, converted into dollars at the time of purchase, and the amount of American dollars required to purchase the same number of Canadian dollars when payment was subsequently made.

Summary of Argument.

Seaboard acquired the 50,000 shares of Campbell stock on March 27, 1946. It paid therefor 100,000 shares of its own common stock as an original issue.

The $2,200,000.00 (Canadian) transmitted to Industrial on March 30, 1946 was a cash collateral deposit made pursuant to the provisions of the agreement of March 27, 1946 for the purpose of securing performance by Seaboard of its obligations under said agreement. It was not payment for the Campbell stock.

Notwithstanding that Seaboard acquired the Campbell stock on March 27, 1946, the cost thereof to Seaboard

was not determined or determinable until November, 1946 when the 100,000 shares of Seaboard stock, which had been issued to Industrial on March 27, 1946, were marketed by Industrial.

The application of the Canadian dollars, which had been deposited in Canada as cash collateral, in satisfaction of the obligations imposed upon Seaboard by the March 27, 1946 agreement resulted in the realization of a gain on foreign exchange in the amount of $189,000.00 (United States).

ARGUMENT.

I.

Analysis of Transaction Pursuant to Which Seaboard Acquired the Campbell Stock.

When Industrial offered the Campbell stock for sale to Seaboard, it wished, if it could, to receive its asking price in full, and to be guaranteed a full cash payment. Seaboard desired to acquire the Campbell stock, but was unable to raise funds sufficient to cover the asking price in cash. Moreover, Seaboard was unwilling to pay a bonus of $1,000,000.00 over net book value if that bonus had to be paid as an out-of-pocket expenditure of cash. Accommodation of the conflicting desires of the parties was necessary.

Seaboard foresaw the possibility of an appreciation in the market value of its stock if it were to acquire Campbell. Public information as to the acquisition of Campbell would, it was believed, stimulate the market for Seaboard's common stock. The agreement of March 27, 1946 was executed by Seaboard in the light of that possibility. By the agreement Seaboard acquired immediate ownership of all of the Campbell stock, with all of the

financial benefits which such ownership would entail. Its only outlay at the time was the issuance of 100,000 shares of common stock to Industrial. Seaboard thus acquired ownership of Campbell without any cash outlay whatsoever.

There can be no question on the facts in this case that Industrial became, on March 27, 1946, the owner of the 100,000 shares of Seaboard stock. In its initial statement [R. 44] that said 100,000 shares were deposited in escrow as security, the Tax Court erroneously found to the contrary. That finding is without support in the record. Physical possession of the shares was, it is true, given to the Canadian Bank of Commerce, which acted as escrow holder. Said escrow was not for securing Industrial, however. It was provided in the contract of March 27, 1946 that the Seaboard shares were to be marketed for the account of Industrial. In the opinion of Seaboard's counsel, a sale of the shares in the United States (the only available market for the stock) by Industrial would necessitate registration with the Securities and Exchange Commission. Immediate filing of a Registration Statement was impossible. Therefore, Seaboard insisted, as a means of protecting itself from possible liability under the Securities Act of 1933, that the 100,000 shares be held in escrow pending the filing of a Registration Statement. The escrow, which merely restricted the transferability of the shares, did not affect Industrial's ownership.

Preparation of the Registration Statement was commenced early in May, 1946. It was hoped that the Statement could be filed and become effective by June or early July. Had it become effective during that period, when a strong over-the-counter market for Seaboard stock existed, the sale by Industrial of the 100,000 shares of Seaboard stock would have produced the entire cash re-

ceipt which Industrial sought. But because of unavoidable delays in the filing of the Registration Statement and the consummation of arrangements with underwriters, Industrial's shares of Seaboard stock could not be marketed until November. As it was, the net proceeds from the sale of the 100,000 shares was $1,440,000.00 (United States). Under its guaranty Seaboard had to make a cash payment or issue additional shares of its common stock. It chose to make a cash payment.

In clearing the accounts between the parties Seaboard and Industrial, for purposes of convenience, authorized the application of the cash collateral deposit of $2,200,000.00 (Canadian) in settlement for the 50,000 shares of Campbell stock, and Industrial authorized the investment bankers to pay to Seaboard the $1,440,000.00 (United States) proceeds from the sale of 100,000 shares of Seaboard stock marketed on Industrial's behalf.

The cash collateral deposit had been made in March, 1946 pursuant to the requirements of the agreement. Seaboard used $2,000,000.00 (United States) to purchase $2,200,000.00 (Canadian). This advantageous purchase could be made because of the favorable rate of exchange then existing between the Canadian and the United States dollar. But when those Canadian dollars were applied in December, 1946 in settlement of the guaranty to Industrial, the Canadian dollar had risen to virtual parity with the United States dollar. The 2,200,000 Canadian dollars which had been purchased for 2,000,000 United States dollars had become, by virtue of the exchange fluctuation, convertible into 2,189,000 United States dollars (the $11,000.00 difference represented a discount of ½ of 1% chargeable upon conversion). It was this benefit which Seaboard treated as a Canadian gain on exchange.

The evidence supports no finding other than that the March 27, 1946 agreement, and all documents executed pursuant thereto, accomplished no purchase by Seaboard of Campbell stock for cash but rather an acquisition by Seaboard through issuance of shares of its own stock, with provision for a later adjustment dependent upon subsequent events. The deposit of cash collateral was not intended by the parties to be, and was not in fact, payment of the purchase price.

II.

General Principles of Law Applicable to Transactions Involving Foreign Exchange.

Income returnable for United States income tax purposes must be expressed in United States dollars. Where foreign exchange is involved, the rate of exchange at the time of realization of the gain governs in making the computation of the amount of gain. *O.D. 419,* 2 Cum. Bull. 60 (1920). Transactions in foreign exchange involve the purchase and sale of foreign currency or the purchase of such currency and the application of it upon the purchase price of property. Such transactions may occur either in the conduct of a trade or business, or as a speculation or investment. *I.T. 3810,* 1946-2 Cum. Bull. 55. The same ruling states that foreign currency is a capital asset under Section 117(a)(1) of the Internal Revenue Code.

No gain or loss is realized on the mere appreciation or shrinkage of value, in United States dollars, of foreign currency. *Theodore Tiedemann & Sons, Inc.,* 1 BTA 1077 (1925); *Tsivoglou v. United States* (CA-1, 1929), 31 F. (2d) 706; *P. Canizzaro & Co.,* 19 BTA 380 (1930). It is necessary that there be a conversion of the foreign

currency in order that gain or loss may be deemed to have been realized. The realization of the gain or loss is postponed until the foreign currency is disposed of or converted.

It is not necessary that the foreign currency be exchanged for United States currency. It is sufficient that the foreign currency be disposed of by applying it in payment for merchandise or the like. *Joyce-Koebel Co.*, 6 BTA 403 (1927), *acq.* VI-2 Cum. Bull. 4 (1927); *Credit & Investment Corp.*, 47 BTA 673, 680 (1942); *Bernuth Lembcke Co.*, 1 BTA 1051 (1925), *acq.* IV-2 Cum. Bull. 3 (1925).

III.

The Tax Court's Ultimate Findings and Conclusions Were Clearly Erroneous.

This case was presented to the Tax Court primarily upon a written stipulation of facts filed by the parties. The only oral testimony presented was that of W. A. Thompson, a witness on behalf of Seaboard. The Commissioner produced no witnesses.

The Tax Court's evidentiary findings of fact [R. 21-44] are based on the matters contained in the written stipulation and the testimony of the one witness. Except as challenged herein those evidentiary findings of fact substantially paraphrase the written stipulation. Accordingly, under the decisions of this Court, the Court is in just as good a position as the Tax Court to decide whether or not the ultimate findings of fact are correct. *Equitable Life Assurance Society v. Irelan* (CA-9, 1941), 123 F. (2d) 462; *Smyth v. Barneson* (CA-9, 1950), 181 F. (2d) 143.

In its analysis of this case, in making its ultimate findings of fact, and in its conclusions, the Tax Court was guilty of two fundamental errors. The challenged findings of fact, which, we submit, are clearly erroneous, are as follows:

(1) That Seaboard's use of foreign exchange in the purchase of Campbell stock in accordance with obligations incurred under the purchase contract of March 27, 1946 did not constitute a transaction in foreign exchange requiring recognition of a taxable gain separate and apart from the subsequent sale of the stock [R. 44].

(2) That Seaboard could determine its cost of the Campbell stock on March 27, 1946 [R. 48].

The Tax Court also made at least one evidentiary finding which is clearly erroneous. This is the finding that the 100,000 shares of Seaboard's stock which were issued by Seaboard in connection with this transaction were required to be deposited in escrow *as security* pending completion of the details of sale [R. 45].

The Tax Court's ultimate findings of fact and its conclusions are based upon a misconception of the transaction and a disregard of the provisions of the contract between Seaboard and Industrial. The Tax Court erroneously found, in effect, that Seaboard agreed to pay a specified number of Canadian dollars for the Compbell stock and, as a means of obtaining said dollars, sold to the public, for Seaboard's own benefit, 100,000 shares of its common stock. This view of the case led to the determination that Seaboard's cost could be determined in dollars and cents at the date the contract was entered into. This approach is clearly erroneous.

A. The Transaction in Foreign Exchange Was Separate From the Campbell Purchase.

The Tax Court's opinion commences [R. 44] with the statement that Seaboard committed itself to purchase the Campbell stock by guaranteeing to Industrial $2,214,-969.94 (Canadian), which amount was to be realized first out of the sale of 100,000 shares of Seaboard's stock issued to Industrial, but to be sold by Seaboard, and secondly, from Seaboard's agreement to make good any deficit. Stopping at this point, it will be noted that the Tax Court recognized that the 100,000 shares of Seaboard's stock were actually issued to Industrial. Though the opinion [R. 45] implies the contrary, the only proper finding based upon the record is that they were then sold by *Industrial* pursuant to arrangements made by Seaboard. They were not sold by Seaboard, as the Tax Court's opinion implies.

The Tax Court then went on to say that Seaboard was required to deposit certain Canadian dollars in escrow as security, as well as the 100,000 shares of Seaboard stock. This is directly contrary to the evidence in the following respects:

(1) It is not correct that the $2,200,000.00 (Canadian) were deposited *in escrow*. Said money, which was, by the agreement, required to be deposited as cash collateral to secure performance of the contract, was required to be, and was in fact, deposited *with Industrial,* not in escrow [R. 29; 37]. The evidence to this effect is set forth in the letter which was sent to Seaboard by the Canadian Bank of Commerce wherein the Bank acknowledged receipt *from* Industrial of a receipt for $2,200,000.00 (Canadian) [R. 37].

(2) It is not correct that the 100,000 shares of Seaboard stock were deposited in escrow as security for performance of the agreement of March 27, 1946. The reason for the deposit in escrow was to restrict Industrial's power of free disposition of the shares. If Industrial had had unrestricted possession of the shares, it could have, whether rightly or wrongly, attempted to market the shares in the United States, that being the only feasible or available market for the shares. Such marketing, however, would probably have been in violation of the Securities Act of 1933 in the absence of prior registration with the Securities and Exchange Commission. Hence the escrow requirement, which was merely a limitation upon the right of marketing. It could not have been a provision to secure Industrial, because the shares were issued to and owned by Industrial. It would have been meaningless for Industrial to deposit its own property as security for the performance by another person of the latter's obligation.

What the record shows is that Seaboard entered into a speculative agreement for the purchase of 50,000 shares of Campbell. To acquire ownership of the shares Seaboard agreed to issue, and did issue, to Industrial 100,000 shares of Seaboard stock. The transaction at this stage constituted an exchange of Seaboard stock for Campbell stock. Had this been an ordinary exchange, it would have ended there. However, Industrial extracted a guaranty from Seaboard that the 100,000 shares of stock were or would be equal in value to $2,214,969.94 (Canadian). This guaranty was expressed in terms of an undertaking by Seaboard to arrange for the sale by Industrial of the 100,000 shares, with the further provision that if the sale did not produce the agreed figure, Seaboard would make

up the difference, either by the issuance of additional shares of Seaboard stock to Industrial or by the payment of cash.

The speculative feature of the contract lay in the expectations and hopes of Seaboard's management that the news of the acquisition by Seaboard of Campbell would stimulate activity in the over-the-counter market for Seaboard stock, thereby increasing its market value and the amount which would be realized by Industrial upon the marketing of its 100,000 shares of Seaboard stock. Reduced to simple terms, Seaboard attempted, in March, 1946, when its stock had a fair market value of $12.50 per share, to acquire all of the outstanding stock of Campbell in exchange for 100,000 shares of Seaboard on the speculation that the fair market value of the Seaboard stock would increase sufficiently so that the entire cash amount which Industrial desired to obtain could be realized by Industrial from the sale of the Seaboard shares. Seaboard was not purchasing the Campbell stock for cash. Its desires and objectives were different from those of Industrial. Industrial wanted to receive a guaranteed cash amount which Seaboard was in no position to pay and did not want to pay. To reconcile this conflict, the transaction was set up on the basis of an exchange of Seaboard stock for Campbell stock, with Seaboard guaranteeing Industrial against loss on the transaction. Such an agreement is far different from an agreement to purchase for cash.

Had Seaboard been able to arrange a sale of Industrial's 100,000 shares of Seaboard stock at or around $22.00 per share (which would have been possible in June or July, 1946 but for the intervention of delaying circumstances), Industrial would have realized the entire amount

which it sought, and Seaboard would have had no obligation to pay cash or to issue any additional shares of its stock. Had that occurred, Seaboard's cost of the Campbell stock would have been the fair market value on March 27, 1946 of the 100,000 shares of Seaboard's stock which were issued to Industrial on the exchange. 3 Mertens, *Law of Federal Income Taxation*, 374. That fair market value having been stipulated to be $12.50 per share, Seaboard's cost would have been $1,250,000.00, which was the approximate net book value of Campbell, and which was the amount that Seaboard proposed to pay for Campbell.

Had Industrial's 100,000 shares of Seaboard stock been marketed in June or July at $22.00 per share, the Commissioner of Internal Revenue would be the first to object if Seaboard thereafter claimed a basis for the Campbell stock of $2,200,000.00.

As it worked out, the sale of the 100,000 shares netted Industrial only $1,440,000.00 This money belonged to Industrial, even though it was held in the United States by investment bankers. Under the contract Seaboard was required, under its guaranty, to make good to the extent of approximately $763,000.00. Seaboard either had to issue additional shares of its common stock to Industrial or to pay that amount in cash.

It is at this point that the transaction in foreign exchange which resulted in a gain in Canada occurred. As the record shows, Seaboard had, in March, 1946, purchased $2,200,000.00 (Canadian) and had deposited it with Industrial, as collateral. Because of the favorable exchange rate at that time, it had cost Seaboard only $2,000,000.00 (United States) to acquire the Canadian dollars. But in November, 1946, when it came time for the

accounts of Seaboard and Industrial to be settled, the Canadian dollar was at parity with the United States dollar. At this point Seaboard authorized Industrial to apply some $763,000.00 of the Canadian funds above referred to in satisfaction of Seaboard's guaranty. In addition, Seaboard and Industrial by mutual agreement effected an exchange of the remaining Canadian dollars back into United States dollars by the letter agreement of November 30, 1946 [R. 40-41].

The record is void of any evidence which would support the Tax Court's finding that the deposit with Industrial of the cash collateral was the payment for the Campbell stock, or not a separate transaction in foreign exchange. On the contrary, the evidence clearly shows that Seaboard could not pay cash, did not intend to pay cash, and never did pay cash except to cover its guaranty.

It was the uncontradicted testimony of W. A. Thompson that:

(1) It was necessary for Seaboard to move promptly in order to obtain the Campbell stock [R. 57].

(2) Seaboard made the offer of an exchange of its stock for Campbell's stock in lieu of a cash offer because Seaboard did not have funds available with which to make a cash purchase and thereafter to finance the Campbell operations; and because the Seaboard management foresaw the possibility of an appreciation in the market value of the Seaboard stock [R. 54].

(3) If the Seaboard stock issued to Industrial could be marketed on behalf of Industrial at a later date at a higher figure than that at which it was currently selling, Seaboard would be acquiring Campbell for substantially less cost [R. 54].

(4) The marketing of the Seaboard stock for the benefit of Industrial was delayed because of difficulties in completing an audit of Campbell Finance Corporation [R. 55-56].

(5) The cash collateral of $2,200,000.00 (Canadian) was deposited with Industrial in order to guarantee the faithful performance by Seaboard of the agreement [R. 57].

(6) Seaboard was not interested in paying Industrial's asking price [R. 54].

The fundamental error of the Tax Court was in disregarding not only the form but the true substance of the transaction, and in finding, contrary to all of the evidence, and contrary to the true substance of the transaction, that in effect Seaboard caused to be sold to the public, for Seaboard's own benefit, 100,000 shares of stock in order to raise the funds necessary to finance the purchase of the Campbell stock.

B. Seaboard Could Not Determine the Cost of the Campbell Stock in March, 1946.

The Tax Court's erroneous analysis of the transaction led to its other fundamentally erroneous finding: that Seaboard's cost of the Campbell stock was determinable on March 27, 1946. It is then stated by the Tax Court that any gain which Seaboard may have experienced on the conversion of Canadian dollars was offset by a corresponding loss sustained between the purchase price of the Campbell stock converted into dollars at the date of purchase and the amount of United States dollars required to purchase the same number of Canadian dollars when payment was subsequently made. The Tax Court's position may be stated in the following way:

(1) Seaboard agreed to pay $2,214,969.94 (Canadian) for the Campbell stock. At the rate of exchange in effect on March 27, 1946 that obligation, in terms of United States dollars, amounted to slightly in excess of $2,000,000.00 (United States).

(2) The claimed gain on the exchange of Canadian currency was $189,000.00, resulting from the increase in value of Canadian dollars between March and November, 1946.

(3) When the $2,200,000.00 (Canadian) were applied in December, 1946 in discharge of Seaboard's obligation, they were worth in terms of United States dollars $189,000 more than they were worth in March, 1946. Consequently Seaboard realized a loss on conversion exactly equal to the claimed gain.

The defect in this reasoning is that its major premise is unsound and is not supported by the facts. There was no fixed purchase price in terms of United States dollars on March 27, 1946, unless that purchase price is taken to be the then fair market value of the 100,000 shares of Seaboard stock.

Seaboard argued below that it could not determine its cost until events subsequent to March 27, 1946 had occurred. The Tax Court dismissed this argument by a mere assumption [R. 47-48]. The Tax Court said: "We assume that under the principles stated petitioner could and should have determined its cost as of March 27, by the mere process of computing from the fixed amount of $2,214,969.94 Canadian at the then rate of exchange its cost in American dollars. In the end result and regardless of what occurred on the marketing of the stock, those Canadian dollars were required to be paid."

Said statement demonstrates the second fundamental fallacy in the Tax Court's approach to this case. To be sure, had Seaboard agreed to pay cash for the Campbell stock, under applicable principles of law Seaboard's cost could have been determined on the date that the contract was signed. But the error of such an analysis has already been described. What Industrial may have sought to achieve from this transaction is not controlling in determining the legal consequences of what Seaboard did. Seaboard issued 100,000 shares of its stock in exchange for 50,000 shares of Campbell stock. The March 27, 1946 agreement expressly so stated and provided. Seaboard at the same time guaranteed to Industrial that its shares would be worth approximately $22.00 per share; and if they were not, that Industrial would be entitled to receive either additional shares to make up the difference or a cash payment.

All that Seaboard had paid or agreed to pay on March 27, 1946 was 100,000 shares of its common stock, which shares were in fact immediately issued to Industrial. Had it been possible for Industrial to market those shares within two to three months following the date of their issuance, Seaboard would have had no cash payment to make to Industrial, and it would have been entitled to receive back from Industrial the $2,200,000.00 (Canadian) which had been deposited as cash collateral. Had those events occurred as Seaboard had hoped they would occur, it would seem very clear that the only cost that Seaboard could claim for the Campbell stock was the fair market value of the 100,000 shares of Seaboard stock which were issued in exchange therefor. Thus, Seaboard would have had a basis for the Campbell stock of $1,250,000.00. Moreover, quite clearly, the conversion of the

cash collateral deposit back into United States dollars and the return thereof to Seaboard would have constituted a completed transaction in foreign exchange upon which gain or loss should be recognized.

It is fallacious to say, as the Tax Court did, that because events did not occur as Seaboard had hoped the transaction became something else. The happenstance of a decline in the market for Seaboard stock commencing in mid-July, 1946 does not alter the transaction which was entered into in March. It required Seaboard to do certain things which it had hoped it would not have to do; but it did not retroactively change an uncertain purchase price into a certain one.

The Tax Court erroneously believed that the cost to Seaboard of the Campbell stock had to be determined as of March 27, 1946. It may be assumed that ordinarily when one person purchases something from another person, the price will be fixed as of the date the transaction is made. Under such circumstances the doctrine of the *Bernuth-Lembcke Co., Inc.,* and *Joyce-Koebel Co.* cases, *supra,* would be applicable. But that doctrine does not have to be applicable in all cases, and we submit that it is not applicable here. The Tax Court said:

> "If the cases in question are applicable petitioner could have computed its cost. And they therefore cannot be held inapplicable on the ground that petitioner could not compute its cost." [R. 48.]

But this statement of the Court is based upon the *assumption* that Seaboard could and should have determined its cost as of March 27. If, for the reasons herein stated, Seaboard could not determine its cost as of March 27, then the cases referred to, in so far as they relate to the

determination of purchase price, are inapplicable to the present state of facts. They are distinguishable because the facts are different. We submit that the Tax Court's assumption, and the findings based upon such assumption, were clearly erroneous.

By virtue of the fluctuation in the rate of exchange, Seaboard realized a gain of $189,000.00 from the purchase and subsequent use of Canadian currency. That gain must be recognized and accounted for as a Canadian gain unless the Tax Court correctly found that there was no such transaction. We submit that there is no evidence whatever to support the Tax Court's finding that the Canadian dollars which were deposited with Industrial were payment, at the date of deposit, for the Campbell stock, and that there was, therefore, no separate transaction in Canadian exchange. We further submit that the Tax Court erred in its assumption that Seaboard could determine its cost on March 27, 1946.

IV.

Conclusion.

The Tax Court concluded its opinion with the observation that Seaboard was in fact no better off or worse off by reason of its transactions in Canadian currency. This is manifestly an erroneous observation. In terms of United States dollars the Canadian currency which Seaboard purchased in March, 1946 was more valuable, by $189,000.00 in December, 1946. Seaboard realized the benefit of this fluctuation. Judge Opper, the Tax Court judge who decided this case below, has recognized that:

> "There seems * * * no reason to disturb the well established principle of such cases as *Bernuth-*

Lembcke, 1 BTA 1051, nor indeed to suggest without qualification in the words of *B. F. Goodrich, supra* [1 T.C. 1098] that 'mere borrowing and returning of property does not result in taxable gain.' * * * In both such situations a collateral transaction in foreign exchange may be involved. * * * The full scope of a taxpayer's gain or loss will not be given effect in his tax liability unless the foreign exchange transaction is also dealt with." *Willard Hilburn, Inc.,* 20 T. C. ...., No. 106 (June 30, 1953).

Unless the purchase and disposition of Canadian currency here in question was nothing more than a cash payment for the Campbell stock, Judge Opper's language quoted above would appear to require that the exchange gain be recognized. We submit that in terms of United States dollars Seaboard profited to the extent of $189,000.00. The computation of its Canadian income tax credit should give full recognition to that gain.

Respectfully submitted,

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Attorneys for Petitioner.

Dated: January 22, 1953.

No. 14,109

IN THE

United States Court of Appeals

For the Ninth Circuit

LOUIS E. WOLCHER,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLANT'S OPENING BRIEF.

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No. 14,109

IN THE

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LOUIS E. WOLCHER,
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APPELLANT'S OPENING BRIEF.

Louis E. Wolcher was accused by an indictment with violating Sec. 145(b) of the Internal Revenue Code (26 U.S.C. 145b). The indictment charged in substance (R. 3) that Louis E. Wolcher on or about October 15, 1944, did attempt to defeat and evade a large part of the income and victory tax due and owing by him, by filing a false and fraudulent tax return for the fiscal year ending June 30, 1944.[1]

The cause was tried before a jury. At the conclusion of all the evidence in the case appellant moved for a judgment of acquittal, which motion was denied

[1]This is the second appeal. There was a prior trial and appeal and this Court reversed with directions for a re-trial. *Wolcher v. United States,* 200 F. (2d) 493.

(R. 6). The jury returned a verdict finding defendant guilty (R. 6). A motion for a new trial was denied (R. 17).

The Court sentenced appellant to two years imprisonment, to pay a fine of $10,000 plus costs of prosecution (R. 17).

From said judgment and sentence appellant prosecutes this appeal.

JURISDICTIONAL STATEMENT.

1. Jurisdiction of the District Court.

18 U.S.C. § 3231, provides that

> "The district courts of the United States shall have original jurisdiction * * * of all offenses against the laws of the United States."

2. Jurisdiction of this Court upon appeal.

28 U.S.C. § 1291, reads:

> "The court of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States * * *."

28 U.S.C. § 1294 reads in part:

> "Appeals from reviewable decisions of the district and territorial courts shall be taken to the court of appeals as follows: (1) from a district court of the United States to the court of appeals for the circuit embracing the district, * * *"

3. The pleadings showing the existence of jurisdiction.

(a) The indictment (R. 3); (b) Plea of Not Guilty (R. 5); (c) Notice of appeal (R. 20).

4. Facts disclosing the basis upon which it is contended that the District Court had jurisdiction and this Court has jurisdiction to review the judgment in question.

These facts are set forth in the prior portion of this brief and will be stated more fully in the following abstract of the case.

STATEMENT OF THE CASE, PRESENTING THE QUESTIONS INVOLVED AND THE MANNER IN WHICH THEY ARE RAISED.

The substance of the indictment has already been set forth.

(a) The sole question of fact involved.

In October, 1944, appellant filed his individual tax return for the fiscal year ending June 30, 1944. No question was raised, except as hereinafter stated, but what said return in all particulars was true and correct.

The Government contended that during said year appellant engaged in transactions involving the purchase of whiskey which he sold over the ceiling price established by the OPA and failed to report the profit made from such sales.

Appellant freely admitted such whiskey transactions, but contended that he made no profit therefrom as he, in turn, had to pay a substantial bonus to procure the whiskey; that he owned or was interested in several taverns selling whiskey at retail by the glass and that sales to outsiders were made

over the ceiling price solely for the purpose of equalizing the bonus he had to pay for procuring the whiskey used in his own taverns.

(b) The business operations of appellant.

Appellant was the owner and operator of the "The Advance Automatic Sales Company" engaged in the wholesale sale of coin operated machines such as candy, peanut, cigarette vending machines, pinball machines, coin operated phonographs such as are used in places of public amusement and taverns; that in 1943 this business had about 1000 customers and was not confined to the State of California (R. 345-6).

Appellant *was not* engaged in the wholesale liquor business or in the business of buying and selling whiskey by the case or carload.

During the year 1943 appellant was identified with certain partnerships, namely: Bay Building Co., California Contract Co., Exhibit Furniture Co., Fun Center Arcade, Gold Coast, Happyland Arcade, Playhouse Arcade, Purety Sweets, The Showboat and Silver Rail (R. 346); appellant individually owned places known as Caruso's, Funland Arcade and the Sacramento Arcade (R. 346).

The Silver Rail, The Gold Coast and The Showboat were taverns engaged in selling liquor by the glass (R. 346).

During said year certain members of appellant's family were engaged in selling liquor by the glass in

places known as Tommy's Joint, Valencia Tavern and the Victory Bar (R. 346-7).

Appellant testified that of the whiskey he purchased during said year, the portions that went to the places with which he was connected or which his relatives operated went to such places at the ceiling price and the portions that went to strangers was sold over the ceiling price (R. 365).

(c) The status of the whiskey market.

During the year involved it was almost impossible for either wholesalers or tavern owners to get whiskey.

The Government called representatives from three wholesale houses who testified as follows:

James Oligny of the George Barton Company testified that it was impossible to get whiskey and that they could not get enough to keep in business (R. 109). Samuel Weiss of the Franciscan Distributing Co. testified that the larger distillers were decreasing the allotments to such an extent that "we were unable to carry on our business" (R. 140). Vance Hammerly of Rathjen Bros. testified they were not receiving sufficient whiskey from the distillers to supply their customers and they had to put their customers on an allotment basis based on the "amount of previous purchases an account might buy, in order to be fair with the allotment of the whiskey we had for sale" (R. 311).

The Government called as witnesses 13 tavern owners who had purchased some of the whiskey involved

over the OPA price.[2] The sum and substance of their testimony was that they had to get whiskey to keep in business, that whiskey was scarce and hard to get, that without whiskey they would not do any business, that they had to buy package deals to get whiskey, etc. (R. 165, 171, 176, 180, 190, 200, 209, 216, 228, 251, 260, 267).

(d) Evidence relating to the 7 whiskey transactions.

The items in issue relate to seven purchases and sales of whiskey. One from Rathjen Bros. of San Francisco. Four shipments from the East that came through the wholesale and distributing firm of Franciscan Distributing Company, and two eastern shipments that came through the firm of George Barton, both being San Francisco firms.

Of the fourteen tavern owners called by the Government twelve purchased their whiskey through Roy Clemmens, John Kirby or Peter Norman. Each of these men operated so-called "routes" in that they placed coin operated machines in various taverns throughout the San Francisco bay area (R. 195, 269, 278) and in turn purchased their equipment from Wolcher. The tavern owners when unable to get whiskey to operate their bars contacted these men and sought to have them procure whiskey for their bars.[3]

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[2]Fred Rocci, Herman Schmidt, Wm. Ackerman, Jack Tardiff, Peter Norman, Don Castle, Pete Caglia, Angelo Lombardo, Samuel Fuentes, John Griffith, John Hafford, Geo. Morris and Jos. Gando.

[3]Wolcher, on cross-examination, testified to several places that procured liquor from the shipments and that he believed he let them have the liquor at the ceiling price (R. 428, 429, 430); however for the purposes of this brief we will assume that all whiskey that went to the places Wolcher or his relatives were not interested in were sold over the ceiling price.

The *modus operandi* in all instances was the same; the tavern owner paid the ceiling price by check and the overage in cash. The cash was paid to Wolcher eventually, the checks went to the wholesale distributing houses.[4]

The Old Brook Whiskey transaction.

This involved the sale of 500 cases of Old Brook Whiskey from Rathjen Bros. to the "Gold Coast" on May 11, 1943, for $25,950 (R. 46).

Vance Hammerly, called by the Government, testified: I am auditor and treasurer of Rathjen Bros. (R. 46); that during 1943 Raymond Worthy, salesman for Rathjen Bros., handled the accounts for the Gold Coast and Silver Rail (two taverns owned by Wolcher) (R. 311); that the sheets (Def's Exhibits C and D) are the ledger accounts of Rathjen's with the Gold Coast and Silver Rail for 1943 (R. 308-9); each of the ledger accounts are marked C.O.D. (R. 312-314); the Gold Coast Ledger sheet shows the sale of 500 cases Old Brook whiskey under date of May 11, 1943, for $29,500; this amount was paid off in four payments, viz: $5,000 on May 14, 1943, $1500 on May 19, $15,000 on May 25 and $4450 on May 28 (R. 315); that there were only 1,000 cases in the Old Brook shipment received by Rathjens (R. 315) of which 500 went to the Gold Coast.[5]

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[4]Except the whiskey from Rathjen Bros. hereafter discussed.

[5]The ledger sheets show that for months before and after the sale to the Gold Coast of the 500 cases for $29,500 that the largest sale for any month, under the allotment system, to either the Gold Coast or Silver Rail never exceeded, in round numbers, $600.

Xavier Grusenmeyer, called by the Government, testified: In 1943 I supervised the books and the cash and made the deposits for the Gold Coast and Silver Rail (R. 52-55); the Old Brook Whiskey cost, including tax $51.90 a case (R. 59); somewhere between 300 and 350 cases were sold (R. 59) at $72 per case (R. 62); I received the money for the sales of which $51.90 per case was deposited in the bank and the balance put into the safe on Wolcher's instructions (R. 62); it was customary to keep large sums of cash in the safe as we had to pay over-ceilings once in a while for different stuff (R. 66) and there was a check cashing stand in the place (R. 67); in effect Mr. Wolcher told me that the difference between the invoice price and the selling price was because he had to pay money over the ceiling price for the whiskey (R. 68).

Jack V. Kent, called by defendant, testified: in 1943 I managed the Gold Coast Cafe; in May I knew Raymond Worthy he was a salesman for Rathjen Bros. (R. 335-6); he called at regular intervals; in May he came in and I asked him if he could help us out with additional stock, he said there was a particular buy on a new brand of bonded whiskey and there was 500 cases available if we could meet the requirements that there would have to be an additional price, under the table price, paid to get the whiskey; I told him that probably Mr. Wolcher would be interested and that I would put him in touch with Mr. Wolcher (R. 336); I don't recall the exact amount but I believe it was $20 a case over the list

or ceiling price (R. 337); the whiskey was Old Brook (R. 343).

Louis E. Wolcher, testified as a witness in his own behalf: In 1943 it was extremely difficult to get whiskey for my taverns (R. 347); in May of 1943 there was a purchase of 500 cases of Old Brook Whiskey from Rathjen Bros. for $25,950; Mr. Kent, manager of the Gold Coast, told me of his efforts to procure whiskey and that he had heard from Ray Worthy, the salesman for Rathjen Bros., that we could get 500 cases of bonded whiskey (R. 348); I met Mr. Worthy and he told me I could get 500 cases of Old Brook for $51 something a case but in order to buy it it would take $20 a case under the table; that is $20 a case over the Rathjen price, I said I would take it; I gave Worthy $10,000 in cash which I got out of the safe in the Silver Rail (R. 349); it is correct that some of that whiskey was sold for around $72 a case and the differential between $51.90 and $72 a case went into the safe where the overage came out of in the first place (R. 350) the first sale to outsiders of this Old Brook whiskey took place 5 or 6 months after its purchase (R. 351).

The four whiskey transactions handled through the Franciscan Distributing Company.

Four shipments of whiskey from the east were handled through the Franciscan Distributing Co. at a cost to Wolcher (without adding any bonus or over-ceiling price) as follows: 100 cases Supreme Bourbon at $33.35 per case ($3,335); 500 cases Schen-

ley Royal Reserve at $38.23 per case ($19,115); 500 cases Golden Wedding Rye at $34.50 per case ($17,-250); 500 pints and 500 fifths of Gallagher & Burton at $37.80 and $30.50 per case ($34,150).

Samuel S. Weiss, of the Franciscan Distributing Co., called by the Government, first identified certain books and records of the Franciscan Co. (R. 113-118), then testified as follows:

In 1943 Mr. Wolcher had a few saloons that we supplied with our regular liquor; Mr. Wolcher asked if we could supply him with more whiskey and I told him it was impossible and that if he wanted more whiskey he would have to go and get it and we would be only to glad to import it for him at approximately $2 a case (R. 122-3); Wolcher said he could make a few connections in the east and if he did he would let us know and we would import it for him (R. 140); he said something about connections in the east with people who were also in the same business as he is who had some liquor connections (R. 141);

We handled four shipments of liquor from the east for Wolcher, 500 cases Royal Reserve, 500 cases Golden Wedding Rye, 1000 cases Gallagher & Burton, 100 cases Supreme Bourbon (R. 141-2); Neither I nor my firm had anything to do with placing the orders in the east for these shipments, we had nothing to do with the negotiations that led up to these shipments coming from the east (R. 142); eventually Mr. Wolcher told us of some arrangements that had been made in the east and that our firm would re-

ceive word from various distilleries in the east as to the shipments; our firm received some invoice or bill of lading from the shippers (R. 143); the liquor was distributed at the direction of Mr. Wolcher (R. 123, 125).

Of the 500 Schenley Royal Reserve we delivered 125 cases to the "Showboat" (R. 128) and 15 cases to the "Victory Cafe" (R. 128).[6]

Of the 500 cases Golden Wedding Rye we delivered 50 cases to the "Showboat" (R. 131);[7]

(The witness' enumeration shows none of the 1000 cases of Gallagher & Burton went to any tavern in which appellant was interested [R. 131]).[8]

The two whiskey transactions handled through George Barton Company.

Two shipments of whiskey from the east were handled through the George Barton Company at a cost to Wolcher (without adding any bonus or over-ceiling price) as follows: 500 cases Gallagher & Burton at $30.50 per case ($15,250) and 2038 cases Old Mr. Boston Rockingchair Whiskey at $26.92 per case ($54,862.96).

James A. Oligny, called by the Government, testified:

In 1943 I was office and credit manager for George Barton engaged in the wholesale liquor business (R. 94); I did not meet Louis Wolcher until the latter

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[6]The Showboat and Victory were taverns in which Wolcher was interested. This whiskey was sold to outsiders at $60 per case.

[7]Golden Wedding Rye sold to outsiders at $60 per case.

[8]Entire 1000 cases sold to outsiders at $60 per case.

part of December, 1943, (R. 95); that is a sight draft that was attached to a bill of lading covering the shipment of 2,038 cases Boston Rockingchair whiskey at the invoice price of $40,230.12 from the Penn-Midland Import Corporation and our check for the same amount (Plaintiff's Ex. 5) (R. 95); the invoice is dated Dec. 3, 1943 and our check Dec. 22, 1943 (R. 97); the George Barton Co. did not pay any amount for that liquor over the amount shown on the invoice (R. 96); (documents identified by witness as invoices for the sale to bars of the 2,038 cases—Plaintiff's Ex. 6) we did not receive any of the money for the sale of this whiskey from any of the purchasers, we received the money from Cy Owens (R. 100); the George Barton Co. received $26.92 per case for the whiskey, the price we were entitled to sell it for under the OPA (R. 101); the profit on the transaction was divided three ways, Wolcher and Owens each received a check for $3,000 less security and federal income taxes (R. 101).

Neither the George Barton Co. or anyone connected with the company had anything to do with procuring this whiskey from the east, we did not place the order, the only contact we had was with Cy Owens who told us the whiskey would be coming from the east (R. 103-4); and the same is true of the first shipment we handled—500 cases of Gallagher & Burton (R. 105).[9]

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[9]The Gallagher & Burton transaction was developed by the defense on cross-examination of Mr. Oligny, although this transaction had been developed at the first trial of the case.

At the last trial of this case I identified the document you show me as one showing the places of distribution and ceiling price per case of the 500 cases of Gallagher & Burton whiskey (admitted as Defendant's Ex. B) (R. 107-8).

We had no control over the persons to whom the shipments of this liquor were made, our agreement with Cy Owens was that we were to distribute the whiskey at his direction (R. 109).

(Plaintiff's Ex. 6 shows that of the 2,038 cases of Mr. Boston Rockingchair Whiskey the following number were delivered to places that Wolcher owned or had an interest in: Gold Coast—100 cases, Silver Rail—100 cases, Show Boat—175 cases, Victory Bar —50 cases, Tommy's Joint—100 cases, Total 525 cases).[10]

(Defendant's Ex. B shows that of the 500 cases of Gallagher & Burton the following number were delivered to places owned by Wolcher or in which he had an interest: Victory Club—100 cases, Tommy's Joint —36 cases. Total 136 cases).[11]

Cy Owens, called by the Government, testified:

I have known Wolcher for 11 or 12 years, I have no present business association with him now (R. 72); in 1943 I owned two taverns in conjunction with Wolcher's 2 nephews—Daniel and Harold Leventhal

[10]The Old Mr. Boston whiskey was sold to outsiders at $60 per case.

[11]The Gallagher & Burton whiskey was sold to outsiders at $60 per case.

—they were Tommy's Joint and the Victory Bar (R. 73); I recall a transaction involving the Mr. Boston Rockingchair whiskey, it came from the Penn-Midland Co. in the east (R. 74); whiskey was hard to get and Mr. Wolcher said he had a friend that said he could get quite a bit of whiskey (R. 75); I had something to do with the whiskey coming to the George Barton Co., (R. 75); I had been in the liquor importing business and had done business with George Barton Co. years previous (R. 76); neither George Barton nor I had any interest in the liquor that was imported (R. 76); as to the Old Mr. Boston liquor there was no fee charged by Barton, we worked it out to divide the profit 3 ways (R. 77); the profit was around $9,000 and was the difference between the cost of the liquor, freight, etc. and the profit the OPA allowed us to sell it at (R. 78); I received Barton's invoice price of the liquor from Mr. Wolcher at his office for the Barton Co., I know nothing about any over-ceiling selling of this liquor (R. 80); the $9,000 profit (divided 3 ways) did not involve the division of any overage or over-ceiling price that anybody paid for the whiskey (R. 83);

Two transactions went through Barton's, the other one was a small one involving 500 cases (R. 83); Tommy's Joint and the Victory Bar, with which I was identified, received some of this liquor that went through Barton's; neither I nor my places paid any overage for that liquor (R. 83); I know that some liquor went to bars that Wolcher was identified with —the Silver Rail, Gold Coast, Show Boat (R. 84);

I had nothing to do with procuring either of these shipments from the east (R. 84).

(e) Testimony of appellant Louis E. Wolcher.

Louis E. Wolcher, testifying in his own behalf, first identified his business activities and companies he owned or was interested in as above set forth, and then testified as follows:[12]

Mr. John Kirby was a friend and customer of mine for some 20 odd years (R. 347); he was an operator of coin-operated machines who had routes and locations in which he placed his (machines); he bought a lot of his equipment from me (R. 348);

Peter Norman had the same type of business and has been a customer of mine for 20 odd years (R. 348); Roy Clemens is in the same line of business and is a customer of mine (R. 348);

As to the four shipments of liquor that came through the Franciscan Distributing Company and the two that came through the George Barton Company, I did not place any order for these whiskies with the eastern shippers and did not know what distillers this whiskey was coming from until after its arrival (R. 351-2);

I contacted one Bill Gersh also known as William Gersh for the purpose of acquiring such whiskey (R. 353); William Gersh published in New York City a coin machine trade paper in which you advertised

[12]Wolcher's testimony relative to the purchase of the 500 cases Old Brook Whiskey from Rathjen's has been set forth above.

things to buy and sell, he was living on the east coast (R. 353); I knew Mr. Gersh for a good many years, prior to and up to 1943 both Mr. Gersh and I, as part of our businesses, traveled around the United States and we would meet in various parts of the country, we entertained each other when I was in the east and he was in San Francisco (R. 354);

Mr. Gersh was not, as far as I know, in the whiskey business (R. 354);

I first had a talk with Mr. Gersh about whiskey in either Chicago or New York in the spring of '43 (R. 355);[13]

As a result of my conversation with Gersh in the Spring of '43 and until the early part of 1944 I sent Mr. Gersh close to $150,000; I first sent him $5,000 in the middle of June, 1943, to get me whiskey, it was to apply to the overage that this whiskey would cost over and above its regular invoice price (R. 358); as a result the first shipment of whiskey arrived from the east through the Franciscan Company (R. 359); about the middle of August I sent Gersh $3,300 (R. 359) and about the end of August I sent him $5,000 (R. 461);

The sum of close to $150,000 I sent to Gersh in various ways: I would issue a check and buy a bank draft for it, or I would buy a bank draft for

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[13]Here appellant was asked what conversation he had with Gersh about whiskey. The Government objected on the ground it called for hearsay and self-serving testimony; the Court sustained the objection (R. 355-6). This entire matter is set forth in *Specification of Error No. 3.*

cash without having issued a check; or I would send the money to him in cash by mail or express, or if I saw him I would deliver it either in cash or check (R. 359-360);

I then sent Gersh $12,500, and then $60,000 of which $30,000 was in cash and $30,000 in the form of a bank draft (R. 360-1); which I delivered to him in his office in New York City; this was all money to be applied against the overage of the whiskey (R. 361); Gersh and I had decided, subject to change, on how much overage I would pay to Gersh for getting the whiskey; the first arrangement was for $20 a case and that continued until I had received 2 or perhaps 3 shipments, then Gersh suggested that I pay him $25 a case (R. 361-2); none of the money I sent or gave to Gersh was used in any manner to pay the invoice price of the whiskey.

After the $60,000, I sent to Gersh by express in December or January $30,000 (R. 362).

During this period of time I received money back from Gersh; the first $5,000 I sent Gersh I drew a check on my own bank account and bought a bank draft for this $5,000 which I sent to Gersh; I received a check back from Gersh for $5,000 and it became an entry in my books; my arrangement with Gersh was, when I issued the check for $5,000 in my own books, I had to account for something or charge it to something, so I put it in as a suspense item, Bill Gersh; when he returned $5,000 by check we put it into the bank account again which cancelled out the (suspense) entry (R. 363-4);

In addition to the sums I mentioned I sent substantial amounts of money to Gersh in cash in lots of a thousand or fifteen hundred dollars at a time; of approximately $150,000 I paid to Gersh I received back $35,000 (R. 369); the understanding with Gersh as to his sending me back some money was that when I didn't have enough overceiling money to send him[14] I would send him cash from my bank account, or in case of the $30,000 check where I had borrowed money which was the same as if it came out of my account, then after I disposed of the whiskey and sent him the over-ceiling money he was to return these items I had actually taken out of my bank account so that I could balance my books—5,000 went out and 5,000 came back (R. 380); I never received any cash back from Gersh, only checks (R. 369);

(Here Wolcher identified certain checks as follows: Check of Advance Automatic Sales Co. dated June 14, 1943, payable to Bank of America for $5,000, signed by Louis E. Wolcher [Def's Ex. E, R. 370]

Draft or Cashier's Check for $30,000 issued by United States National Bank of Portland, Oregon, Nov. 3, 1943, payable to Louis E. Wolcher. Endorsed by Louis E. Wolcher and "Bill Gersh, the Cash Box". Deposited or cashed in the Corn Exchange Bank Trust Company, New York on Nov. 9, 1943 [Def's Ex. F, R. 372]

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[14]Wolcher testified that many times the outsiders buying the whiskey over the ceiling price would pay in advance, *i.e.*, before the shipment arrived (R. 364).

Bank (Cashier's) check for $12,500, issued by the Bank of America, San Francisco, Sept. 29, 1943, payable to order of Bill Gersh. Endorsed "Bill Gersh, Cash Box". Deposited or paid by The Corn Exchange Bank Trust Company, October 4, 1943. [Def's Ex. I, R. 378]

Check of the Cash Box, signed by Bill Gersh, dated New York, Aug. 13, 1943, for $5,000 payable to order of Lou Wolcher, drawn on Corn Exchange Bank Trust Co., N. Y. Endorsed by Lou Wolcher. [Def's Ex. G, R. 374.]

Check of the Cash Box, signed by Bill Gersh, dated New York, Feb. 1, 1944, payable to Advance Automatic Sales Co. for $22,750, drawn on Corn Exchange Bank Trust Co. [Def's Ex. H, R. 375.]).

(*Witness Continuing*): In addition to the foregoing I received a check for $2,000 sent and signed by Mr. Gersh's wife (R. 379) (Def's Ex. J); the only money transactions that appeared on my books were the $5,000 and the $30,000 drafts (R. 380); the check for $12,500 does not appear on my books (R. 379);

Gersh paid out some money for me to the Runyan Sales Co., Newark, N. J.; Gersh had told me that his accountant had cautioned him he had better have a reason for washing all this money through his bank and Gersh suggested that the next time I buy any equipment in the east to contact him and allow him to make the purchase for me, so that it would in some measure account for his handling all this money for me. I told Gersh I had purchased some

phonographs from the Runyan Sales Co. and that he should make the initial payment or deposit; as a result he paid the Runyan people $5,250 (R. 376-7);[15]

I kept no books as such of my dealings with Mr. Gersh, but I did keep a record at the time (R. 382); in the preparation of my income tax return for the fiscal year ending in 1944, I knew at that time I had made no taxable profit on these transactions (R. 381); figuring the cost of this liquor at the invoice price and what I had to pay to Gersh I didn't make any money on the transactions and there was no point in reporting it (R. 366); the sales made over the ceiling price so far as I knew equalled or approximately equalled the overage a case I had to pay for the use of this whiskey in my own taverns and those of my family (R. 366); I did not put the transactions in my books because the OPA was then in effect and my books would have been evidence convicting me of black market operations (R. 366).[15a]

After both sides had rested appellant moved the Court to re-open the case in order that he could

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[15]Note that Wolcher sent checks totalling $47,500 and only received checks back totalling $29,750, add to this $5,250 paid by Gersh to Runyan Sales Co. and Gersh only returned to Wolcher $35,000, the exact amount of the two items that appeared on Wolcher's books.

[15a]There was no dispute that if Wolcher's testimony was true he made no profit on the whiskey transactions. A mathematical computation of the amounts he said he paid compared to the number of cases sold to outsiders over the ceiling prices, shows no taxable profit.

subpoena William Gersh as a witness to identify the transcripts of his bank account with the Corn Exchange Bank of New York. The Court denied the motion. The full proceedings in this regard are set forth in *Specification of Error No. 4.*

At the conclusion of all the evidence appellant moved for a judgment of acquittal, which motion was denied (R. 6).

The Court instructed the jury and committed error in the giving and refusal of certain instructions. *Specification of Errors Nos. 1 & 2.*

The jury returned a verdict finding defendant guilty and appended thereto the following: "The Jury recommends leniency" (R. 6).

The Court sentenced appellant to imprisonment for 2 years, to pay a fine of $10,000 and costs of prosecution (R. 19).

SPECIFICATION OF ERRORS.

Specification No. 1.

The trial Court erred in instructing the jury as follows:

> "So that in my opinion brings the issue of the case down to a very simple (question), and that is this—that since the Government has proved and the defendant has admitted receiving the cash over ceiling prices, the issue is whether you do or do not believe the testimony and story told by the defendant in the case. If you believe his story, then you should return a verdict of not

guilty. If you are convinced beyond a reasonable doubt that his story should not be believed, then you are justified in returning a verdict of guilty" (R. 483).

To the giving of the foregoing instruction appellant duly objected as follows:

"Then your Honor instructed the jury that in your opinion this came down to a question of believing the defendant's story, and your Honor instructed the jury that if they disbelieved the defendant's story, they should find for the Government. Well, we note an exception to that instruction. There is other evidence in the case that doesn't depend solely upon defendant's story to establish a reasonable doubt which is all the defense has to do as to any of the elements recorded here" (R. 487).

Specification No. 2.

The trial Court erred in refusing to instruct the jury as requested in Defendant's Requested Instruction No. 21, reading as follows:

"In determining whether the defendant made any profit on his purchases and sales of whiskey, you must determine from all the evidence in the case, the actual amount the defendant paid for the whiskey and the actual amount the defendant received for the whiskey; in determining what amount the defendant paid for any whiskey involved in this case, you must add to the actual cost of said whiskey, any amounts of money, if any, that Wolcher paid to any person as a bonus or commission or fee for procuring such whiskey for him" (R. 12).

To the refusal to so instruct the jury appellant duly objected as follows:

> "Now as to our requested instruction No. 21, I desire to note an exception for the following reasons. This instruction instructed the jury that in the computation of whether or not the defendant made any profit out of these whiskey transactions, that they had to consider as part of the cost of these whiskies, any monies he had to pay as the result of bonuses, commissions and so forth, if they find he had so paid any. Your Honor didn't instruct on that or give any other instruction covering the subject" (R. 490).

Specification No. 3.

The trial Court erred in sustaining objections by the Government to questions asked of appellant, on his direct examination, as follows:

> "Q. When did you first have any talk with Mr. Gersh about whiskey? About when?
>
> A. Oh, it was in the spring of '43. * * *
>
> Q. And what conversation did you have with Mr. Gersh at that time?
>
> Mr. Schnacke. If your Honor please, this obviously is an effort to get in hearsay testimony, self-serving hearsay at that, into evidence. The fact that there was a conversation I think is unobjectionable, but I will object to the details or nature of this conversation.
>
> Mr. Friedman. This man is on trial. He is entitled to tell what occurred.
>
> Mr. Schnacke. We have had hearsay all morning that I haven't objected to, but I must object at this point, your Honor.

Mr. Friedman. Well, I don't know what Mr. Schnacke thinks hearsay is.

The Court. Well, I don't see how, Mr. Friedman, the hearsay rule could be avoided. Of course the defendant can testify to anything that he did.

Mr. Friedman. Well, he did—he had a conversation.

The Court. What he may have said to some other man or some other man may have said to him is hearsay; at least it is at this stage of the proceedings.

Mr. Friedman. Of course, I am trying to present this matter in some more or less chronological order. I can turn it around and say, 'Did Mr. Gersh get you some whiskey?' 'What led up to it?' We have the same thing. He certainly has a right—your Honor will recall the opening statement of what the defense is here: That he had negotiations with Mr. Gersh. With someone. I don't know whether I mentioned Mr. Gersh in opening statement, and he had to pay overage for this whiskey.

The Court. I am not saying any factual matters are not admissible. The only question now, is that conversation that he had with the man, which wouldn't prove any fact in the matter.

Mr. Friedman. Well, it explains what happened.

The Court. If the explanation is hearsay, that doesn't make it admissible because it is an explanation.

Mr. Friedman. It isn't hearsay.

The Court. The fact——

Mr. Friedman. Could we give only half of the transaction and say, 'Did you get this whiskey?'

'What did you pay for it?' 'Well, I paid this price for it when I(t) came. I gave John Smith so much money.'

The Court. The witness can testify to what he did in that regard.

Mr. Friedman. But he is allowed to explain why he did it.

The Court. The circumstances. At this time I will sustain the objection on the ground that it is hearsay.'' (R. 354-6.)

Specification No. 4.

The trial Court erred in denying defendant's motion to reopen the case in order that defendant might call William Gersh as a witness, all of which fully appears from the following portions of the record:

The trial was resumed on Monday, August 31, 1953, at 10 A.M. (R. 460.) Both sides rested at about 10:30 A.M., and the trial was continued to 1 P.M. for arguments to the jury. (R. 467.) At 1 P.M. the following proceedings were had out of the presence of the jury (R. 468-472):

Mr. Friedman. If it please the Court, in this matter Your Honor will recall I attempted to identify some documents by calling Mr. Appling to the stand. I was unsuccessful in doing it. Since our adjournment I have been advised, and I don't know how true it is that Mr. William Gersh is here under subpoena for the government. If that is so, he would be the best witness to identify these documents; and if that is so, I would either like to have him produced or find out

where he is so that we can produce him in order to do so, if Your Honor please.

I may say in passing that I consider this document to be of vital interest to the defendant's case; otherwise I would not have attempted to put it in.

Mr. Schnacke. If your Honor please, Mr. Gersh, as I understand it, has been in town since last night. Mr. Gersh was advised on Friday that he was not required to be here as a government witness; nonetheless he has come to San Francisco. I have determined this by means of investigation. Mr. Gersh has not been in touch with the government. I have no way of knowing that he is here. Obviously, he was brought out by someone other than the government. He was originally subpoenaed. He was notified that he was not to appear. Nonetheless he appears to be in town.

Now this matter was known certainly to the defendant. I don't know whether Mr. Friedman knew it this morning, but I am satisfied that Mr. Wolcher or his associates knew it this morning.

The Court. I don't understand what you want me to do, Mr. Friedman. This case was submitted this morning.

Mr. Friedman. I understand that, Your Honor.

The Court. I am not going to send out at this stage because you say somebody is here in San Francisco, to send out the Marshal hunting for him. This isn't the time to do that at this stage of the case. I just don't see what the point is that you are making here.

Mr. Friedman. This point is that I have no other way of establishing these documents.

The Court. That may be also, but if you had wanted to establish the documents, you could have subpoenaed him or had him brought here. After the matter is submitted by both sides this morning, you say that information has come to you. The government says they have heard he is in town. What is there that you want me to do now?

Mr. Friedman. I am going to ask Your Honor to reopen the case to be allowed to subpoena Mr. Gersh.

The Court. I will deny the motion. There is no showing—I shouldn't be as abrupt as that, but there is no showing made of any reason for it, when the case is ready to go to argument, when there has been ample opportunity to subpoena witnesses and the case is at this late stage, that you want to go out and send a subpoena for this man.

When are you going to get him? Do you know when he can be brought in here or anything along that line? No, no, that application is not timely in any sense of the word.

Mr. Friedman. It is timely in this sense, that he is here in San Francisco.

The Court. Apparently there was ample opportunity during the weeks before this case was set for trial to arrange for the presence of the witness if you wanted him here. At this point in the case it seems to me that it would be contrary to the interests of justice to stop the case now at a point when it is ready for argument after having been adjourned at

10:30 this morning for the purpose of allowing counsel to prepare their arguments.

Mr. Friedman. I have made my presentation. May I ask one more question of Mr. Schnacke? Would you be willing to stipulate that those are the bank records of Mr. Gersh? They were introduced at the last trial; they were identified by the government.

The Court. Wasn't this man a witness at the last trial?

Mr. Friedman. For the government.

The Court. No matter who he was a witness for, he was here, and there would have been opportunity to inquire concerning this matter that you speak about concerning the bank records.

Mr. Friedman. He identified them at the last trial.

The Court. That may be so, but there is no opportunity to interrogate him concerning those records. I don't know what is in them.

Mr. Schnacke. There were a lot of matters gone into at the last trial that we have not gone into at this trial.

Mr. Friedman. That is true.

Mr. Schnacke. I don't see that contract has any connection with this case. Mr. Friedman met Mr. Gersh and knows of his connection with the case. As Your Honor says, if he had wanted him, he could have subpoenaed him to appear.

Mr. Friedman. I didn't think we would have any difficulty in establishing these documents in view of the fact they were identified at the last trial and in view of the fact that they are their documents, be-

cause the record shows that the government examined Mr. Gersh.

The Court. The statement was made on last Thursday that the defense rested, but the Court said that if there were any further questions that were to be asked of Mr. Wolcher, that the Court would not deny the right to either side to ask some question that had been overlooked, and this morning the defendant resumed the stand. He was questioned for not more than three minutes by both sides together, and then counsel sought to introduce, I assume as a part of his case although he had already rested, through a witness some document that has to do with the bank account of a witness who is not here, and when that witness couldn't identify the bank account, why, then the defendant rested.

Mr. Friedman. That is right. That is what I did.

The Court. Now that was at 10:30 this morning, and the case is now set for argument and the record now discloses the nature of your application. I can see no ground whatsoever that appeals to the Court's discretion or sense of justice that would now say that you could at this late time try to locate some witness for the purpose of presenting these documents, so I shall deny the motion. I assume the motion that I am denying is the motion that counsel just made to continue the case for the purpose of subpoenaing the witness.

Mr. Friedman. And so my record will be clear, in support of the motion may I offer and ask that there be marked for identification what was Govern-

ment's Exhibit 37 at the last trial and Defendant's Exhibit G at the last trial.

The Court. Those are documents that you are offering for identification only to show what you are referring to in your motion?

Mr. Friedman. That is right.

The Court. All right; let them be marked for identification.

The Clerk. Defendant's Exhibits O and P marked for identification.

(Whereupon the documents referred to were marked Defendant's Exhibits O and P for identification.)

The Court. Had there been a timely application, Mr. Friedman, the Court would have given time to produce this witness.

Well, I think I have said enough. Bring the jury in. We will proceed with the argument.

ARGUMENT.

Once again Louis E. Wolcher appeals to this Court on the ground that due to rulings of the trial Court and the actions of the prosecuting attorney he was denied a fair trial as guaranteed by the Constitution and prevented from presenting a full and complete defense to the charge against him.

The denial of a fair and impartial trial, as guaranteed by the Sixth Amendment, is also a denial of due process as guaranteed by the Fifth Amendment, and the failure to observe these Constitutional safe-

guards renders a trial and conviction void (*Baker v. Hudspeth* (10 Cir.), 129 F. 2d 779).

Precluding a defendant from making a full defense is a violation of the Constitutional right to a fair trial (*Atwell v. United States* (4 Cir.), 162 F. 97; *Sunderland v. United States,* 19 F. 2d 202, 216; *Estep v. United States,* 327 U.S. 114, 125, concurring opinion of Mr. Justice Murphy).

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1. THE COURT ERRED IN INSTRUCTING THE JURY THAT THE GUILT OR INNOCENCE OF APPELLANT DEPENDED ON THE TRUTH OR FALSITY OF HIS "STORY".

Specification of Error No. 1.

The trial judge, *sua sponte,* instructed the jury as follows:

> "So that in my opinion brings the issue of the case down to a very simple (question), and that is this—that since the Government has proved and the defendant has admitted receiving the cash over ceiling prices, the issue is whether you do or do not believe the testimony and the story told by the defendant in the case. If you believe his story, then you should return a verdict of not guilty. If you are convinced beyond a reasonable doubt that his story should not be believed, then you are justified in returning a verdict of guilty." (R. 483.)

This instruction was highly prejudicial to the rights of appellant: (a) It shifted the burden of proof from the Government to appellant; (b) it took from the

jury the question of whether the Government's evidence established the charge beyond a reasonable doubt; (c) it, in effect, told the jury to disregard all other evidence in the case save the testimony and "story" of defendant and to decide his guilt or innocence solely upon his testimony; (d) it told the jury to discount or ignore weaknesses in the Government's case if the jurors found appellant's testimony to be unworthy of belief.

This Court, on February 15, 1954, decided the case of *Olender v. United States* (..... F. 2d .....) in which case the trial judge gave an instruction far less prejudicial than the one given herein. This Court, in an opinion by Judge Bone, held the instruction given in the *Olender* case to have been erroneous and stated:

> "The vice of the instruction in issue is that it tended to divert attention from the question whether the government evidence established these facts beyond a reasonable doubt, to the presence or absence or nature of the defendant's 'explanation'. On the basis of this instruction the jury might have discounted great weaknesses in the government's case because of the silence of the defense. While the words of the instruction did not in terms shift the burden of proof to the defendant, they well might have had that effect in the minds of the jurors. * * * it is particularly important to keep the jury's attention riveted upon the ultimate question whether the government has sustained its burden of proving the crime charged beyond a reasonable doubt. See Demetree v. United States, 5 Cir., 207 F. 2d 892;

Lurding v. United States, 6 Cir., 179 F. 2d 419, 422."

This Court, in the *Olender* case, then refers to and quotes from *Bihn v. United States,* 328 U.S. 633, as follows:

> "The challenged instruction is in some ways similar to that given in Bihn v. United States, 328 U.S. 633, 637. That case involved a prosecution for conspiracy to steal ration coupons. The defense was that persons other than the defendant could have stolen the coupons. The trial judge instructed fully that the burden was upon the government to prove the crime charged, beyond a reasonable doubt, but he also instructed: 'Who would have a motive to steal them? Did she (the defendant) take these stamps? You have a right to consider that. * * * Did she steal them? Who did if she didn't? You are to decide that.' The Supreme Court held that the giving of the instruction was reversible error, saying '* * * to put the matter another way, the instruction may be read as telling the jurors that, if the petitioner by her testimony had not convinced them that some one else had stolen the ration coupons, she must have done so.' 328 U.S. at 637."

Immediately following the foregoing language in the *Bihn* case, the Supreme Court stated (328 U.S. at 637):

> "So read, the instruction sounds more like comment of a zealous prosecutor rather than an instruction by a judge who has special responsibilities for assuring fair trials of those accused

> of crime. See Quercia v. United States, 289 US 466, 469, 77 L ed 1321, 1324, 53 S Ct 698."

The case at bar is on all fours with the case of *Bihn v. United States.* Here, the complained of instruction not only "may be read as telling" but actually told the jurors that if appellant had not convinced them by his "story" that he made no profit from the whiskey transactions then he should be found guilty.

In *Ezzard v. United States,* 7 F. 2d 808, 811, it is stated:

> "In no condition of proof is it permissible to instruct a jury that it had become the duty of defendant to establish his innocence to obtain an acquittal."

There was ample evidence, without considering appellant's testimony, that would have justified the jury in finding the Government's case had not been established beyond a reasonable doubt.

The Government called representatives from three liquor wholesale and distributing houses. Oligny of the George Barton Co. testified that it was impossible for that company to get whiskey and that they could not get enough to keep in business (R. 109); Weiss of the Franciscan Co. testified that the larger distillers were decreasing allotments to such an extent that they were unable to carry on their business (R. 140); Vance Hammerly of Rathjen Bros. testified they were not receiving sufficient whiskey to supply

their customers and they had to put their customers on an allotment basis, based on the average amount a customer had bought (R. 311).

Each of the tavern owners called by the government testified that it was almost impossible to get whiskey (R. 165, 171, 176, 180, 190, 200, 209, 216, 228, 251, 260, 267).

The evidence established that Wolcher was not in the wholesale liquor business, or in the business of buying and selling whiskey in either case or carload lots. This very fact was sufficient to raise a doubt as to whether Wolcher could acquire the 7 lots of whiskey without having to pay a bonus therefor, when licensed dealers could not do so.

As to the Old Brook whiskey purchased through Salesman Worthy from Rathjen Bros., the ledger sheets of Rathjen's showed that the Gold Coast and Silver Rail taverns of Wolcher were on an allotment basis of not exceeding $600 per month; that they were on a C.O.D. basis; that in May, 1943, 500 cases of Old Brook whiskey was sold to the Gold Coast for $25,950 (R. 46) and this was not paid for on delivery but was paid off in four installments (R. 315, and Def's Ex. C & D). Hammerly also testified that Rathjen's only received one shipment of 1,000 cases of this Old Brook whiskey and 500 cases thereof were sold to the Gold Coast (R. 315). Grusenmeyer testified that when he received the money for the sales of this whiskey he deposited the Rathjen cost in the bank and put the surplus in the safe and that Wol-

cher told him the differential was because he had to pay money over the ceiling price for the whiskey (R. 68). Jack Kent, called by defendant, testified that Worthy told him that he could supply 500 cases of this whiskey but there would have to be an additional under the table price paid (R. 336) and he believed that $20 a case over the list price was mentioned by Worthy (R. 343).

As to the other transactions, Roy Clemens, who arranged many of the sales to tavern owners, testified that when he asked Wolcher if it were possible to get any whiskey for his tavern locations, that Wolcher told him "he knew where there was some available, but it was black market and the price was high * * * that he wasn't making a dime out of it" (R. 291-2).

All of the foregoing facts were sufficient to have justified the jury in finding a reasonable doubt as to the Government's proof and as to whether Wolcher, when no one else could, was able to get whiskey in large shipments without he, in turn, having to pay over the ceiling price for same. The complained of instruction took from the jury the consideration of all the foregoing matters and left appellant's guilt or innocence to be determined solely on whether the jury believed or disbelieved Wolcher's testimony.

2. THE COURT ERRED IN REFUSING TO INSTRUCT THAT IN COMPUTING THE PRICE PAID FOR THE LIQUOR THE JURY SHOULD ADD TO THE INVOICE PRICE ANY BONUS OR COMMISSION PAID BY WOLCHER.

Specification of Error No. 2.

The Court refused to instruct the jury as requested in Defendant's Requested Instruction No. 21, reading as follows (R. 12):

> "In determining whether the defendant made any profit on his purchases and sales of whiskey, you must determine from all the evidence in the case, the actual amount the defendant paid for the whiskey and the actual amount the defendant received for the whiskey; in determining what amount the defendant paid for any whiskey involved in this case, you must add to the actual cost of said whiskey, any amounts of money, if any, that Wolcher paid to any person as a bonus or commission or fee for procuring such whiskey for him."

The Court gave no other instruction covering this matter.[16]

The requested instruction correctly stated the law (*Wolcher v. United States,* 200 F. 2d 493). It was a basic and vital issue in the case. The refusal to defi-

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[16]The only instruction given that smacks of the proposition is as follows: "The defendant, on the other hand, admits that the black market transactions were had by the defendant, but contends that he made no profit in connection with these transactions and that therefore he had no net income and that therefore he is not chargeable with any evasion of income taxes; that he made no profit in the matter, because he had to pay out certain monies in connection with the transactions and that therefore the net result was that he had no profit in the matter, and that therefore he is not chargeable with a violation of federal statute." (R. 483.)

nitely instruct on so vital an issue constituted prejudicial error (see *Bollenbach v. United States,* 326 U.S. 607, 614).

It was the Court's duty to instruct on all essential questions of law involved in the case (*Samuel v. United States,* 169 F. 2d 787 (9 Cir.)).

The very condition of the Government's case made it imperative that the Court instruct the jury as requested by appellant.

The Government had introduced in evidence, as a judicial admission of Wolcher, (1) an information filed in the California District Court charging the defendant Wolcher, in several counts, with having sold certain whiskey (involved in the present case) over the maximum prices established by law, and (2) the minute order showing that Wolcher plead guilty to Counts 1, 2 and 3 thereof (R. 246-7).

The Government called as a witness one Thomas E. Haywood, who testified: I am an Internal Revenue agent since 1945; prior to that I was in the United States Marine Corps, prior to that I was with the California Franchise Tax Board; I am a public accountant (R. 320-1); I was one of the revenue agents assigned to the investigation of Louis Wolcher (R. 321); the tax return (Plaintiff's Ex. 1) of Wolcher for the fiscal year ending June 30, 1944, is the return concerning which my audit and investigation was made (R. 321). None of the books (of Wolcher businesses) that I examined reflected any profit on whole-

sale liquor sales transactions (R. 325); in my opinion the tax return of Wolcher does not contain or include as net income any income derived from the wholesale of liquor, except $3,000 that is properly reported from George Barton Co. (R. 326);

In the course of my investigations I ran across evidence of these whiskey transactions; as part of my duties I computed what I considered to be the profit that Mr. Wolcher made in these transactions (R. 330); I took all the cash payments that I found Mr. Wolcher had received in these whiskey transactions as taxable income (R. 331-2); in my computations I made no allowance for any deductions except the ceiling price of the whiskey (R. 332).

Thus, the jury had before it the fact that Wolcher had been criminally accused of and plead guilty to black market operations concerning some of the very whiskey involved in the present action, and that an Internal Revenue agent and public accountant had considered and *computed all the overceiling prices collected by Wolcher as taxable income.*

In the absence of a proper instruction—that overceiling prices *paid by Wolcher* had to be considered as part of his cost—the jury could, and probably did, come to the conclusion that any money received by Wolcher over the invoice price to him constituted taxable income and, as he had not reported the same in his tax return, that he was guilty as charged.

3. THE COURT ERRED IN REFUSING TO REOPEN THE CASE TO ALLOW APPELLANT TO CALL WILLIAM GERSH AS A WITNESS.

Specification of Error No. 3.

In order to fully present the error in the Court's action in refusing to reopen the case and the misconduct of the Assistant United States Attorney relative thereto, it is necessary to set forth the matters leading up to the making of the motion.

The Government had concluded its case in chief showing the purchase of the whiskey and certain sales over the ceiling price. Appellant then testified as a witness in his own behalf, stating in substance that he paid William Gersh $20 and $25 a case for his procuring the whiskey for him. Wolcher then testified that he sent approximately $150,000 to Gersh (R. 380); that he specifically sent the following sums to Gersh in cash or by check: June 14, 1943, $5,000 by check (R. 363); August, $3300 in cash (R. 359); August, $5,000 in cash (R. 461); Sept. 29, $12,500 by check (R. 360, 378); Nov. 9, $30,000 by check and $30,000 in cash (R. 360, 372); Dec., 1943 or Jan., 1944, $30,000 in cash (R. 362). In addition Wolcher sent various sums to Gersh in cash (R. 369).

Wolcher further testified that where he had drawn checks that appeared as entries in his books (2 checks totalling $35,000) he would subsequently send Gersh the cash on the understanding that Gersh would send back a check for such amounts in order that Wolcher's books would be balanced (R. 369); that Gersh had only returned by checks $29,750 which, plus the $5,250

paid on account of phonographs, totalled the $35,000 (R. 374, 375, 380).

Following Wolcher's testimony and on Monday, Aug. 31, 1953, appellant called as a witness Richard H. Appling, the special agent, Intelligent Unit, Treasury Department, who was the agent in charge of the investigation of Wolcher's tax return (R. 464). In reply to questions Appling testified that in the course of the investigation he did not procure a copy of the bank account of William Gersh with the Corn Exchange Bank of New York (R. 465); that he could not identify a document that was the Government's Ex. 37 at the first trial, that he had never seen the document until after the conclusion of the first trial (R. 465-6).[17] Thereupon appellant asked that Mr. Schnacke (the Ass't U. S. Attorney) take the stand (R. 466). Mr. Schancke stated that he had no knowledge of the documents, that he was not present at the first trial (R. 467). On this statement appellant stated he would not call him as a witness.

Thereupon both sides rested the case (R. 467) and at 10:30 A.M. on Monday, Aug. 31, 1953, a recess was taken until 1 P.M. at which time arguments to the jury were to be presented (R. 467).

At 1 P.M. appellant moved the Court to re-open the case to permit him to subpoena William Gersh as a witness to identify the records of Gersh's bank account with the Corn Exchange Bank. The motion

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[17]The document was a ledger sheet of the Corn Exchange Bank of Gersh's account.

and the proceedings thereon are fully set forth under our *Specification of Error No. 4, supra* p. 25, the material portions being as follows (italics ours):

"Mr. Friedman. If it please the Court, in this matter your Honor will recall I attempted to identify some documents by calling Mr. Appling to the stand. I was unsuccessful in doing it. *Since our adjournment I have been advised,* and I don't know how true it is *that Mr. William Gersh is here under subpoena for the government.* If that is so, he would be the best witness to identify these documents; and if that is so, I would either like to have him produced or find out where he is so that we can produce him in order to do so, * * * I consider this document to be of vital interest to the defendant's case * * *.

Mr. Schnacke. If your Honor please, Mr. *Gersh,* as I understand it, *has been in town since last night. Mr. Gersh was advised on Friday that he was not required to be here as a government witness; nonetheless he has come to San Francisco. I have determined this by means of investigation. * * * He was originally subpoenaed. He was notified that he was not to appear. Nonetheless he appears to be in town.* (R. 468-9) * * *

The Court. I am not going to send out at this stage because you say somebody is here in San Francisco, to send out the Marshal hunting for him. This isn't the time to do that at this stage of the case. I just don't see what the point is that you are making here.

Mr. Friedman. The point is that I have no other way of establishing these documents.

The Court. That may be so, but if you had wanted to establish the documents, you could have subpoenaed him or have him brought here. After the matter is submitted by both sides this morning, you say that information has come to you. The government says that they have heard he is in town. What is there that you want me to do now?

Mr. Friedman. I am going to ask your Honor to reopen the case to be allowed to subpoena Mr. Gersh.

The Court. I will deny the motion. There is no showing—I shouldn't be as abrupt as that, but there is no showing made of any reason for it, when the case is ready to go to argument, when there has been ample opportunity to subpoena witnesses and the case is at this late stage, that you want to go out and send a subpoena for this man. * * * No. No. That application is not timely in any sense of the word.

Mr. Friedman. It is timely in this sense, that he is here in San Francisco.

The Court. Apparently there was ample opportunity during the weeks before this case was set for trial to arrange for the presence of the witness if you wanted him here. At this point in the case it seems to me that it would be contrary to the interests of justice to stop the case now at a point when it is ready for argument after having been adjourned at 10:30 this morning for the purpose of allowing counsel to prepare their arguments" (R. 469-470) * * *

"Mr. Friedman. He (Gersh) identified them at the last trial. * * *

I didn't think we would have any difficulty in establishing these documents in view of the fact they were identified at the last trial and in view of the fact that they are their (the Government's) documents, because the record shows that the government examined Mr. Gersh." (R. 471) * * *

"Mr. Friedman. And so my record will be clear, in support of the motion may I offer and ask that there be marked for identification what was Government's Exhibit 37 at the last trial and Defendant's Exhibit G at the last trial.

The Court. Those are documents that you are offering for identification only to show what you are referring to in your motion?

Mr. Friedman. That is right.

The Court. All right; let them be marked for identification.

The Clerk. Defendant's Exhibits O and P marked for identification.

The Court. *Had there been a timely application, Mr. Friedman, the Court would have given time to produce this witness."* (R. 472-3.)

Before discussing the law applicable to the situation, we demonstrate how prejudicial to appellant it was not to have been able to have the two bank statements identified and admitted in evidence.

With the exception of the check for $12,500 (Def's Ex. I, R. 378) and the draft for $30,000 (Def's Ex. F, R. 372), each of which carried the endorsement of Bill Gersh and was deposited or paid by the Corn Exchange Bank, New York, *there is no other testi-*

mony in the record, except that of Wolcher, that Gersh ever received any other money from Wolcher.

Gersh was called by the government as a witness in rebuttal at the first trial of the action and admitted he had received $85,000 in cash and check from Wolcher and that these sums were deposited in his bank account; he identified and testified from his two bank statements involved herein. These statements show deposits made in his bank account on dates and in amounts that exactly coincide with and corroborate the testimony of Wolcher, viz.: June 15, $5,000; Aug. 11, $3,300; Aug. 31, $5,000; Oct. 2, $12,500; Nov. 9, $30,000 and Jan. 4, 1944, $30,000. Correlating these bank statements of deposits with Wolcher's testimony we have the following:

Wolcher's testimony re: Money paid Gersh			Deposits in Gersh's bank account	
June 14	(check)	$ 5,000	June 15,	$ 5,000
Aug.	(cash)	3,300	Aug. 11,	3,300
Aug.	(cash)	5,000	Aug. 31,	5,000
Sept. 29	(check)	12,500	Oct. 2,	12,500
Nov. 9	(check)	30,000	Nov. 9,	30,000
Nov. 9	(cash)	30,000		
Dec.	(cash)	30,000	Jan 4,	30,000
	Total	$115,800		$85,800

Of the $85,800 that thus would have been traced into Gersh's bank account, there was as we have pointed out above only $29,750 returned by check and $5,250 paid on account of the phonographs, a total of $35,000 which corresponds exactly with Wolcher's testimony that when he sent a check drawn on his

own bank account, he would later send cash so that Gersh would send a check back in order that Wolcher could balance his book entries (R. 369). The check for $12,500 was bought with cash which did not come out of Wolcher's bank account and did not appear on his books.

The entire defense was based on fact that Wolcher had sent or delivered to Gersh large sums of money as a bonus or over ceiling price for Gersh getting the whiskey for him.

The Court instructed the jury that Wolcher's guilt or innocence depended on their belief or disbelief of Wolcher's "story". Under this instruction the jury may well have found that Wolcher did not send such sums to Gersh as his testimony in this regard was uncorroborated. If the two bank statements had been identified and then admitted in evidence an entirely different situation would have been presented to the jury, Wolcher's testimony would have been corroborated in great part.

For the trial Court to have denied appellant the opportunity to subpoena Gersh and thus have the documents properly identified, constituted a gross abuse of discretion on the part of the trial judge.

Not only did the Court instruct the jury that they should find for or against Wolcher depending on whether they did or did not believe his testimony; but the Court also instructed the jury as follows:

> "The Government contends, as stated by the Government lawyer, that the defendant's account

> of sending large amounts in cash through the mail and otherwise to someone in the East is a story that is fabricated and should not be believed by you'' (R. 483).

Under the instructions of the Court the jury may well have found that Wolcher did not send such sums to Gersh as his testimony in that regard was uncorroborated and that Wolcher's ''story'' was untrue and therefore he was guilty.

If Wolcher had been given an opportunity to subpoena Gersh and have him identify his two bank statements, an entirely different situation would have been presented. Wolcher's testimony would have been corroborated.

The action of the Court in denying this opportunity to appellant affected his substantial rights, was and is prejudicial error and denied appellant the right to fully and fairly present his defense.

While the reopening of a case for further testimony rests in the discretion of the trial Court, a refusal to reopen under proper circumstances constitutes an abuse of discretion and prejudicial error.

> ''Where it appears, on application to reopen a case to permit the introduction of further testimony, that the proposed testimony is of substantial importance to accused, the application should be granted.''
>
> 23 *C.J.S.* p. 463, sec. 1055.

In *United States v. Maggio,* (3 Cir.) 126 F. 2d 155, the Government rested its case and defendants made a

motion for acquittal; thereupon the Government moved to reopen the case in order to call an additional witness; this the trial Court allowed. The Appellate Court stated:

> "We see no basis for holding that the trial judge abused his discretion in permitting the testimony of Benatre to be offered out of order. On the contrary the fact that that testimony was not available to the government until a few minutes before it was offered makes it clear that the court's action was quite proper."

In *People v. Oxnam,* 170 Cal. 211, 215; 149 Pac. 165, the California Supreme Court stated:

> "While the matter of allowing a party to reopen his case is one committed to the discretion of a trial court, if it had been made to appear to the lower court the proposed testimony was of any substantial importance to defendant, we should say that in the exercise of that discretion an opportunity should have been given to introduce it."

In *People v. Roberts,* 131 Cal. App. 376, 385; 21 Pac. 2d 449, the reopening of the case on motion of the prosecution, after all the testimony was closed, was upheld. The ground of the motion to reopen was that the prosecution did not know of the materiality of the testimony *until the previous Saturday afternoon.*

In every instance where a defendant has appealed on the ground that the Court abused its discretion in allowing the Government to reopen the case for

further testimony after all the testimony had been closed and after defense had moved for judgment of acquittal, this and other Appellate Courts have invariably held that there had been no abuse of discretion. (*McGrew v. United States,* (9 Cir.) 281 F. 809; *Burke v. United States,* (9 Cir.) 58 F. 2d 739, 741; *Horowitz v. United States,* (5 Cir.) 12 F. 2d 590; *Reining v. United States,* 167 F. 2d 362, 364; *United States v. Maggio, supra.*) Clearly, *the right of a defendant to reopen his case should at least be held equal to that of the prosecution.*

The trial judge had read the opinion of his Court rendered on the first appeal (R. 243). The Government knew of the prior opinion and what Gersh had testified to at the first trial, including his identification of the bank statements and the amounts that had been deposited in his bank. The bank statements had been produced by the Government at the first trial. The Government had subpoenaed Gersh as one of its witnesses at the second trial (R. 468-9).

The importance to defendant of the bank statements cannot be gainsaid. Gersh had been called as a witness in rebuttal at the first trial, identified the statements and disputed Wolcher's testimony as to the purpose for which the money had been sent by Wolcher to Gersh.

Wolcher did not know of the presence of Gersh in San Francisco until sometime between 10:30 A.M. and 1 P.M. of the day the motion was made to reopen. The Government stated that Gersh had only arrived

in San Francisco the previous night (R. 468). The motion to reopen was timely made. It was not until after the Government rested at 10:30 in the morning[18] that Wolcher knew that the Government was not calling Gersh as a witness.

The exact situation was recently passed upon in a civil case decided by the California Court of Appeal, *we adopt the language of that Court as our argument herein.*

In *Hayes v. Viscome,* 122 A.C.A. 167 (decided December 17, 1953) plaintiff sued for personal injuries. Shortly before trial at the request of defendants, she was examined by a Dr. Berryman. Dr. Berryman had not been called as a witness by defendants, whereupon plaintiff called one of the defendants' attorneys and asked him if he had not arranged for medical examination of Mrs. Hayes and that Dr. Berryman had made the examination. Objections were sustained to these questions. At this time defendants had closed their case and at 2:30 on Friday afternoon, plaintiff's attorneys requested a continuance until Monday in order to give them an opportunity to bring in Dr. Berryman. In support of their motion they explained that they were taken by surprise by defendants' fail-

[18]In discussing the motion the judge erroneously stated that on the previous Wednesday the defense had rested its case (R. 471). On the previous Wednesday the Government concluded its case in chief and the case was adjourned until Thursday for the defense to start (R. 334). On Thursday the case was adjourned until Monday for the completion of the defense and for such rebuttal as the Government had to offer (R. 457-9). The defense did not rest until Monday at which time the Government also rested without offering any rebuttal testimony (R. 467).

ure to call the doctor and by the Court's ruling; that they had not placed the doctor under subpoena because they had not anticipated that it would be necessary to call him as a witness for the plaintiff. The Court refused the requested continuance upon the ground that plaintiff should have had the doctor under subpoena; that there were too many cases to permit a delay and that it would be an abuse of discretion to grant the continuance.[19]

In holding that it was an abuse of discretion to deny the continuance, the California Appellate Court at p. 172 stated:

> "The court stated to counsel that they should have known much earlier that they would have to call Dr. Berryman. They could not have known this unless they had known that defendants did not intend to call him, and to assume this would be to assume that defense counsel knew that the doctor's testimony would be adverse. *The matter arose as soon as defendants had rested their case and it was not until then that plaintiff's counsel knew that defendants would not call the doctor.* The fact that there were other cases awaiting trial did not warrant a denial of the requested continuance. A litigant is entitled to a fair share of the court's time, and may not be deprived of an opportunity to present his case fully and fairly because someone else is being inconvenienced by having to wait his turn. No lawyer can foresee or predict all the vicissitudes that will occur in the course of a contested trial, which

[19]Note the identity of reasons in the *Hayes* case and the instant case for refusing to grant the continuance to call a witness.

> often consists of unpredictable rulings of the court. *Plaintiff's attorneys were not negligent in failing to anticipate that defendants would not call Dr. Berryman. They acted promptly and their request for a continuance was reasonable.* * * * The court stated no sound reason for denying the continuance and we can discover none. Had we been in the position of the trial judge we would have considered denial of the requested continuance to be an abuse of discretion. As a reviewing court, our views are not different, and we cannot put them aside merely because the trial judge believed it would be an abuse of his discretion to grant the continuance. We must be guided by the dictates of our own judgment and experience, and we hold that plaintiff's case was prejudiced for no good reason by denial of her request of a short continuance." (Italics ours.)

The action of the prosecutor in having subpoenaed Gersh and then telling him not to appear *amounted to a suppression of evidence necessitating the granting of a new trial.*

The prosecuting attorney knew everything that Gersh had testified to at the first trial. He had subpoenaed Gersh as a witness. On Thursday, at the close of the court session when the case was being continued to the following Monday for the completion of the defense, the prosecutor stated to the Court:

> "The Court. Will the Government, as the case stands now, have some rebuttal or not?
>
> Mr. Schnacke. I am inclined to think there will be some, your Honor, * * *. I have some rebuttal witnesses, if your Honor please" (R. 455).

"Mr. Schnacke. If your Honor please, the Government witnesses were subpoenaed for Friday, and when Mr. Friedman explained that his case would require a witness to appear on Monday, on that information I then advised all the Government witnesses that they should not appear until Monday.

Mr. Friedman. May I ask if they are all local witnesses?

Mr. Schnacke. I don't recall at the moment, Mr. Friedman" (R. 457-8).

At the close of Court *on Thursday, Gersh was still under subpoena by the Government.* On Monday Mr. Schnacke stated *"Mr. Gersh was advised on Friday that he was not required to be here as a Government witness"* (R. 468). On Thursday the prosecutor could not recall whether all his witnesses were local witnesses.

In other words, the prosecutor refused to state that he had a foreign witness under subpoena and excused Gersh from attending without notifying the defendant that Gersh was being excused.

In view of the foregoing matters and things, appellant had the right to rely on the assumption that Gersh would again be called as a Government rebuttal witness after appellant rested his case. (See *Hayes v. Viscome, supra*). There was no rebuttal evidence.

In *Griffin v. United States,* 182 F. 2d 990 (C.A.-D.C.), (a trial for homicide) a motion for a new trial was made on the grounds of newly discovered evidence in that after the trial the defense had discov-

ered that the victim had an open knife in his pocket and that the prosecution knew at the time of the trial that such testimony was available but neither produced it in Court nor disclosed it to the defense. The Court of Appeals reversed and remanded the cause stating on page 993 as follows:

> "However, the case emphasizes the necessity of disclosure by the prosecution of evidence that may reasonably be considered admissible and useful to the defense. When there is substantial room for doubt, the prosecution is not to decide for the court what is admissible or for the defense what is useful. 'The United States Attorney is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done.' *Berger v. United States,* 295 U.S. 78, 88, 55 S.Ct. 629, 633, 73 L.ed. 1314."

In the case of *In re Curtis,* 36 Fed. Supp. 408, 410, (D.C. 1941), the Court stated:

> "Of course if any action on the part of the prosecution amounts to the suppression of evidence, such would offend the constitutional guaranties of a person accused of crime."

In the case of *U. S. v. Schneiderman,* 106 Fed. Supp. 731, 739 (S.D. Cal. 1952), the Court said:

> "In all events, the Attorney-General—no less than the United States Attorney—labors in every criminal prosecution under the solemn duty *ex*

mero motu to see that 'justice shall be done'. *Cf.* Berger v. United States, 1935, 295 U.S. 78, 88-89, 55 S. Ct. 629, 633, 79 L. Ed. 1314. To that end he cannot properly withhold from the court evidence essential to proper disposition of the case, including *a fortiori* any evidence which may be material to the defense of the accused. See Canon 22, Canons of Professional Ethics, 62 A.B.A. Rep. 1112-1113 (1937)."

See also the following cases:

Berger v. United States, 295 U.S. 78, 88;
Read v. United States (8 Cir.) 42 F. 2d 636.

The prosecution, knowing that there had been some testimony given by Gersh at the first trial supporting the testimony of Wolcher, should not have excused Gersh as a witness without advising the defense of such action. The proper procedure was outlined and approved by this Court in the case of *Sullivan v. United States* (9 Cir.) 32 F. 2d 992, where the Government at the conclusion of its case announced through the U. S. Attorney that three men (convicts) were in custody in the county jail and unless the defense desired to keep them here as witnesses that they would be immediately returned to their respective penitentiaries; *that the Government was not going to use them as witnesses but they were available to the defense in the event they wanted to use them.* On an assignment of error this Court stated:

"There was no misconduct on the part of the district attorney. The witnesses were in the custody of the government, and subject to the

order of the court, and it was quite proper that the defendant and the jury and the court should be advised of the fact that they were to be sent out of the jurisdiction of the court without appearing as witnesses in the case, unless desired by the defendant."

So here the Government knew the materiality of Gersh's testimony, had subpoenaed him as a witness, had announced that it would produce rebuttal testimony, as it had done at the first trial; all these matters justified Wolcher in believing that Gersh would again be called as a witness by the Government. When the Government promptly rested its case after the defense had closed, the defense should have been given an opportunity to produce Gersh who was then in San Francisco, having arrived the night before.

The action of the Government in these circumstances amounted to a suppression of evidence and constituted unfair tactics denying appellant a fair trial and thus preventing him from presenting a full and complete defense to the charge against him.

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4. THE COURT ERRED IN SUSTAINING OBJECTIONS TO QUESTIONS ASKED OF APPELLANT REGARDING HIS CONVERSATIONS WITH WILLIAM GERSH.

Specification of Error No. 3.

Appellant, on direct examination, testified that the shipments of liquor from the East had come to the distributing houses for him (R. 352-3), and then testified that he had contacted William Gersh for the pur-

pose of acquiring this whiskey (R. 353), that his first conversation with Gersh was held in the spring of '43 (R. 354). He was then asked "And what conversation did you have with Mr. Gersh at that time?" (The entire matter, objections of the Government, statements and ruling of the Court, etc., is set forth in our *Specification of Error No. 3, supra,* p. 23.)

The Government objected to the question on the ground that it called for self-serving hearsay testimony (R. 355).

The trial judge sustained the objection of the Government, basing his ruling on the following grounds: "Well, I don't see, how, Mr. Friedman, the hearsay rule could be avoided. Of course the defendant can testify to anything he did." (R. 355); "What he may have said to some other man or some other man may have said to him is hearsay" (R. 355).

> "The Court. I am not saying any factual matters are not admissible. The only question now, is that conversation that he had with the man, which wouldn't prove any fact in the matter.
>
> Mr. Friedman. Well, it explains what happened.
>
> The Court. If the explanation is hearsay, that doesn't make it admissible because it is an explanation.
>
> Mr. Friedman. It isn't hearsay.
>
> * * * * * * *
>
> The Court. The witness can testify to what he did in that regard.
>
> Mr. Friedman. But he is allowed to explain why he did it.

> The Court. The circumstances. At this time I will sustain the objection on the ground that it is hearsay." (R. 356.)

Both the Court and Government counsel were mistaken as to what constitutes hearsay testimony. The conversation called for did not seek to elicit something that Gersh said he had done at some other time and place. This would have been hearsay. The conversation called for the arrangement between Wolcher and Gersh by which Gersh was to get the whiskey for Wolcher and the terms and conditions under which Gersh was to act. This was not hearsay.

In *Sparks v. United States* (6 Cir.), 241 Fed. 777, several of the defendants were charged with using the mails in furtherance of a scheme to defraud depositors and creditors of a bank. Defendants offered to show by defendant Sparks, who was a witness, that as cashier of the Chickasaw Bank he had a conference with the president of the First National Bank of Memphis as a result of which Sparks proceeded to make loans and discounts relying on this conversation, etc. The witness was permitted to testify that he had an arrangement with the corresponding bank by which the latter agreed to rediscount paper for the Chickasaw Bank when the latter needed it, but the Court refused to permit the conversation to be stated. The Court of Appeals at page 791 held as follows:

> *"Proof of the actual conversation, so far as it bore directly upon the claimed arrangement, was*

not hearsay. It was the best evidence of the claimed agreement—pertinent to one of the main issues in the case. The bare statement of the witness that Omberg had said that they 'would help us in case my loans became too heavy,' and that the correspondent bank 'agreed to rediscount' (paper) for him 'if it became necessary,' *was a mere conclusion of the witness, and would not necessarily have the full probative effect of testimony of the actual statements made by Omberg, who was not present at the trial, and apparently not in the state at the time. We think defendants had the right to have the conversation given as it occurred, and thus the benefit of whatever persuasiveness of truth the actual language might carry.*" (Italics ours.)

It was Wolcher's sworn testimony that he paid Gersh $20 to $25 a case for procuring the whiskey. Wolcher was not restricted to a mere statement that as a result of the conversation he received some whiskey and sent Gersh some money. He was entitled to tell the jury in complete detail his entire dealings with Gersh. As said in the *Sparks* case, *supra,* defendant "had the right to have the conversation given as it occurred and thus the benefit of whatever persuasiveness of truth the actual language might carry".

The crime with which Wolcher was charged involved criminal intent. He had the absolute right to introduce any evidence tending to rebut an evil intent including the conversations with third persons or statements made by them tending to support his testimony.

In the case of *Haigler v. United States* (10 Cir.), 172 F. 2d 986, the Court states as follows:

> "We have said that where, as here, motive or bad purpose is an essential element of the offense charged, the accused may not only directly testify that he had no such motive or purpose, but he may, within rational rights, buttress such statement with testimony or relevant circumstances, *including conversations had with third persons or statements made by them, tending to support his statement.* * * *" (Italics ours.)

In *Cooper v. United States* (8 Cir.), 9 F. 2d 216, the Court said:

> "The defendants were entitled to show anything that might have a tendency to demonstrate, however slight such demonstration might be, that they were honest and not dishonest persons in their dealings with the government."

Appellant was denied a fair trial. He was prevented from presenting a full and complete defense. The Court committed prejudicial error in its rulings and instructions to the jury, both given and refused. The judgment and conviction should be reversed.

Dated, San Francisco, California,
March 10, 1954.

Respectfully submitted,
LEO R. FRIEDMAN,
Attorney for Appellant.

No. 14,109

IN THE

United States Court of Appeals

For the Ninth Circuit

LOUIS E. WOLCHER,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the District Court of the United States for the Northern District of California.

BRIEF FOR THE UNITED STATES.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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OPINION BELOW.

The District Court wrote no opinion.

JURISDICTION.

THE PLEADINGS AND FACTS DISCLOSE THAT THE DISTRICT COURT HAD JURISDICTION AND THAT THIS COURT HAS JURISDICTION TO REVIEW THE JUDGMENT IN QUESTION.

The appellant, Louis E. Wolcher, was indicted on October 4, 1950, in the District Court for the Northern District of California, Southern Division, on one

count, charging that he willfully and knowingly attempted to evade and defeat a large part of the income and victory taxes due and owing by him for the fiscal year ended June 30, 1944, in the amount of $30,949.81, in violation of Section 145(b), Internal Revenue Code, 26 U.S.C., Section 145(b). (R. 3, 4.)[1]

On January 18, 1951, the defendant entered a plea of "not guilty" to the indictment. (R. 5.) Trial was held in the District Court before the Honorable Louis E. Goodman on August 31, 1953, and the jury returned a verdict finding the defendant guilty as charged in the indictment. (R. 6.) The District Court adjudged the defendant guilty as charged and convicted, and ordered him committed to the custody of the Attorney General for imprisonment for a period of two years and to pay a fine in the sum of $10,000.00 and the cost of prosecution. (R. 17.)

The appellant filed a motion for a judgment of acquittal (R. 6) and a motion for a new trial (R. 17), which motions were both denied.

A timely notice of appeal was filed by appellant on September 4, 1953. (R. 20-21.) The Government concedes that this Court has jurisdiction to hear and decide this appeal.

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[1]This is a second trial. The previous trial was held on May 4, 1951, and this Court reversed on November 17, 1952, *Wolcher v. United States,* 200 F. (2d) 493.

STATUTE INVOLVED.

Title 26, Internal Revenue Code: Section 145(b).

"PENALTIES

* * * * * * *

(b) Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution."

QUESTIONS PRESENTED IN THIS CASE.

1. Did prejudicial error occur in the instructions given by the District Court to the jury, or in the rejection of appellant's proposed instruction?

2. Did the District Court err in sustaining objections to questions asked of appellant on direct examination?

3. Did the District Court abuse its discretion in denying appellant's motion to reopen the case?

STATEMENT OF THE CASE, INCLUDING FACTUAL MATTERS INVOLVED.

On October 15, 1944, Louis E. Wolcher filed with the Collector of Internal Revenue at San Francisco, California, his individual income tax return for the fiscal year ended June 30, 1944. (R. 40.) Appellant testified that he had operated the Advance Automatic Sales Company for thirty years, and that it sold at wholesale coin operated machines, candy, peanuts, cigarette vending machines, pinball machines, and juke boxes. He further stated that up until "it became illegal to have slot machines" this concern had sold slot machines. (R. 345.) Wolcher stated that during the period covered by the indictment he was identified with the following partnerships: Bay Building Company, California Contract Company, the Exhibit Furniture Company, the Fun Center Arcade, Gold Coast, Happyland Arcade, Playhouse, Purity Sweets, the Showboat, and the Silver Rail, and that he also owned individually Caruso's, the Funland Arcade, and the Sacramento Arcade. (R. 346.) The appellant further testified that liquor was sold by the glass for consumption on the premises at the Silver Rail, the Gold Coast, and the Showboat. (R. 346.) He then added that members of his family were identified with Tommy's Joint, Valencia Tavern, and the Victory Bar. (R. 346-347.)

A photostatic copy of Wolcher's income tax return was received in evidence as Government's Exhibit No. 1 (R. 40) and showed that during the year in-

volved in this case appellant reported no gross income from sales of liquor at wholesale, except for $3,000 he obtained from a profit made on liquor he bought from the Barton Distributing Company. The profit so reported did not involve a violation of O.P.A. price ceilings. (R. 87, 323, 325.)

The Government's proof of understated income in this case consisted of testimony that over-ceiling payments for whisky were made direct to Wolcher himself or were made to other persons who passed the money on to Wolcher. A series of Government witnesses[2] gave evidence which establishes its case in this respect. It was sometimes necessary to trace the money through one or two intermediaries before proving that it reached Wolcher.

The whisky involved was received through San Francisco liquor wholesalers who were licensed as required by law. The almost universal practice, with the exception of Rathjen Bros., was that the purchaser would give a check for the ceiling price of the liquor, which was received by the legitimate wholesaler, and would pay the additional over-ceiling amount in cash directly, or through other persons, to Wolcher.

Wolcher did not put the over-ceiling payments in his bank account, where he deposited the regular

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[2]Ackerman (R. 179); Castle (R. 202); Caviglia (R. 210); Clemens (R. 278); Fuentes (R. 223); Gando (R. 263); Hafford (R. 247); Kirby (R. 269); Lombardo (R. 219); Norman (R. 195); and Owens (R. 72).

receipts of his businesses. These over-ceiling payments were the only whisky receipts he handled in this fashion. In at least one instance, the currency so received went into the safe at the Silver Rail Restaurant. (R. 350.)

After the Government had established its case in chief by clear-cut evidence that appellant had received a large amount of income from over-ceiling whisky transactions, Wolcher admitted such over-ceiling transactions. (R. 366, 410.) Appellant testified that he charged over-ceiling prices on the distribution of liquor at wholesale to concerns in which he or his family were not interested, but contended that sales to concerns in which he or his family were interested were made at ceiling prices. (R. 315.)

Wolcher's testimony involved seven purchases and sales of whisky totaling some 5,138 cases at an average sale price of approximately $60 per case, or transactions involving over $300,000. (R. 410.) By far the greater part of this whisky was sold by Wolcher at over-ceiling prices to individuals or to business concerns in which he and his relatives had no ownership interest, although approximately 1500 cases or more (appellant was not sure of the number[3]) were distributed through bars in which Wolcher or his relatives were interested.

As noted above, Wolcher admitted receiving the proceeds from over-ceiling sales of liquor and his

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[3]In the previous trial he estimated 900 cases were distributed through bars in which his relatives were interested. (See p. 7 of appellee's brief, No. 12,992.)

entire defense was to contend that he made no profit. In reply to a question as to why appellant went into a transaction involving over $300,000 without intending to make any profit, appellant stated (R. 411):

> "I didn't intend for it to reach any such mammoth proportions; I didn't intend for any such thing to happen, and that is the reason it was stopped. When it began to reach into big figures it was stopped immediately. The thing was running away from me. Instead of just getting whisky for a friend of his, it turned out that he was getting whisky for three friends of his, and getting ninth removed from that, and that is why it was stopped."

Wolcher testified in very considerable detail as to his version of the transactions between himself and one William Gersh. He asserted that he had known Gersh for a good many years and identified him as the publisher of a New York or a Chicago trade paper called The Cash Box, devoted entirely to coin machines. Wolcher stated that Gersh was not in the whisky business and, further, that he had no correspondence regarding liquor transactions with Gersh, although he had a lot of correspondence with Gersh on other matters. (R. 354-392.) Wolcher also testified that he made over-ceiling payments of approximately $150,000 to Gersh. He testified that he paid Gersh $20 a case on the first two or three shipments and $25 a case on the later shipments. (R. 361, 362.) He also testified that he sent money to Gersh in many different ways: by check, by cash through the mail, by

express, by delivering it to Gersh personally, and by "just stuffed the money in an envelope without registering it." (R. 401-404.)

Wolcher asserted that he sent Gersh $5,000 in the month of June 1943, $3,300 in cash in August 1943, and $5,000 in cash the latter part of August. (R. 358-359.) He further stated that he sent a draft for $12,500 in September 1943. (R. 396.) In the same month, he received back from Gersh a check for $5,000, which became an offsetting entry in Wolcher's books, posted in the suspense account. (R. 363, 364.) Neither the original entry in his books nor the offsetting entry showed the transaction as a whisky purchase or sale. (R. 395.)

Wolcher stated that he talked to Gersh both face to face and over the telephone, and asserted that he delivered to Gersh $30,000 in cash and a bank draft for $30,000. He testified that he carried the cash to New York in his wife's cosmetic case (R. 401), but he later could not recall whether it was he or his wife who carried it (R. 402).[4]

In regard to cashing the $30,000 draft which appellant took to New York for the purpose of delivering to Gersh, his testimony was not too clear on cross-examination as to whether he was with Gersh in the bank or not when the draft was cashed. However, in the first trial (No. 12,992, R. 536) he stated:

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[4]In the first trial, no mention was made of how this $30,000 in cash was carried to New York. (No. 12,992, R. 451.)

"Yes, I recall going to the bank with Mr. Gersh some time after the $10,000, after he got the $10,000, at which time he got $20,000, put it in an envelope and threw it to me, and he says, 'Lou, it is your money, you might as well carry it.' So we walked across—I got the envelope and walked across the street to Mr. Gersh's office, and gave it back to him there."

Wolcher claimed that in December 1943 or January 1944 he had sent Gersh $30,000 in cash by express. (R. 402.) He stated that the express shipment was only insured for a very nominal sum; that it was not described as money; and that he received no receipt for same. (R. 403.)

Appellant admits that at about this same time he received from Gersh a check for $22,750 and another check for $2,000, and about $5,250 worth of merchandise, and the $5,000 previously referred to, or a total of some $35,000. (R. 405.) Appellant further admits that the financial transactions between him and Gersh, on which there is a written record in the form of drafts, checks, and memorandum, totaled $47,500 sent by Wolcher to Gersh and only $35,000 was returned by Gersh to the appellant, leaving a difference of $12,500 in the hands of Gersh. (R. 406.) All of the other amounts claimed by appellant to have been sent to Gersh were carefully handled so that there was no record. (R. 406.)

Appellant stated that he had jotted figures on the back of an envelope which purported to represent

cash sent to Gersh and that he threw away the memorandum at the end of each shipment. (R. 437, 438.) He added that he had thrown away the envelope because he didn't want to leave any telltale trails behind him. (R. 405.) (He didn't explain how figures on an envelope could be used to convict him of O.P.A. violations.)

To have a story which was at all plausible, Wolcher had to explain the fact that Gersh sent him money in large amounts. The jury had the right to consider the improbability that a man of Wolcher's resources and with thirty years of business experience would send a large amount of money across the continent, have it returned to him, and send it back again—all for the asserted purpose of not making a record—when he was establishing such a record in the process.

Appellant stated that his wife was not present when he paid the $60,000 previously mentioned to Gersh. (R. 402.) Moreover, he admitted that in his dealings with Gersh he did not keep any regular books as to the standing of their accounts. Appellant did not call Gersh as a witness.

In addition to the six shipments of liquor allegedly bought through Gersh, appellant testified that in May 1943 he made an over-ceiling payment of $10,000 cash to one Ray Worthy in connection with a purchase of 500 cases of Old Brook whisky from Rathjen Bros. in San Francisco. Worthy died in 1949, and was

unavailable as a witness at the trial. (R. 349, 350, 351.)

SUMMARY OF ARGUMENT.

The instructions of the trial court, when read in their entirety, correctly defined the rights of the Government and the accused and fully and fairly presented the law applicable to the case. The comments of the court during the instructions were within the bounds of judicial propriety, and the jury was left free to perform its fact finding function.

The sustaining of objections by the Government to questions asked of appellant on direct examination did not prejudice the appellant inasmuch as the substance of the conversation with Gersh held in the spring of 1943 was later given and made a part of the record.

The denial of the appellant's motion to reopen the case was a proper exercise of the trial court's discretion, for the appellant was aware of the fact that Gersh had been called as a witness at the first trial of the case and was fully aware of Gersh's testimony on that occasion. Appellant had every opportunity to place Gersh under subpoena, as he admitted he had a conversation with him in the past twelve months and knew his whereabouts. The court pointed out to appellant that this application was not timely in any sense of the word and denial of the defendant's motion to reopen was a proper exercise of the discretion of the trial court.

ARGUMENT.

I.

PRELIMINARY STATEMENTS APPLICABLE TO ALL QUESTIONS INVOLVED AND TO ALL ASSIGNMENTS OF ERROR.

Scope of Review on Questions of Insufficiency of the Evidence.

It is a well-established principle that an appellate court should indulge in all reasonable presumptions in support of the rulings of a trial court and, therefore, that it will draw all inferences permissible from the record, and, in determining whether the evidence is sufficient to sustain a conviction, will consider that evidence, in the light most favorable to the prosecution.

Henderson v. United States, 143 F. (2d) 681 (C.C.A. 9th);

Pasadena Research Laboratories v. United States, 169 F. (2d) 375 (C.C.A. 9th), certiorari denied, 335 U.S. 853, 69 S. Ct. 83;

Borgia v. United States, 78 F. (2d) 550 (C.C.A. 9th), certiorari denied, 296 U.S. 615, 56 S. Ct. 135;

Morrissey v. United States, 67 F. (2d) 267 (C.C.A. 9th), rehearing denied, 70 F. (2d) 729, certiorari denied, 293 U.S. 566, 55 S. Ct. 77;

McFee v. United States, 206 F. (2d) 872 (C.A. 9th), certiorari denied, March 15, 1954.

An appellate court in making its determination is in no way concerned with the weight of the evidence

inasmuch as questions of credibility are a matter for determination in the trial court.

Pasadena Research Laboratories v. United States, 169 F. (2d) 375 (C.C.A. 9th), certiorari denied, 335 U.S. 853, 69 S. Ct. 83;

Newman v. United States, 156 F. (2d) 8 (C.C.A. 9th), certiorari denied, *sub. nom. Cain v. United States,* 329 U.S. 760, 67 S. Ct. 115.

The proof in a criminal case need not exclude all doubt but need go no further than to reach that degree of probability where the general experience of men suggest that it has passed the mark of reasonable doubt.

Henderson v. United States, 143 F. (2d) 681, 682 (C.C.A. 9th);

Pasadena Research Laboratories v. United States, 169 F. (2d) 375 (C.C.A. 9th), certiorari denied, 335 U.S. 853, 69 S. Ct. 83.

II.

THE ESSENTIAL INSTRUCTIONS TO THE JURY WERE CORRECTLY GIVEN AND ADDITIONAL INSTRUCTIONS REQUESTED WERE PROPERLY DENIED.

The entire instructions of the court to the jury are reproduced herein in the appendix attached hereto.

A. The Instructions Given.

Appellant objected to the following portion of the Judge's charge:

> "So that in my opinion brings the issue of the case down to a very simple (question), and that is this—that since the Government has proved and the defendant has admitted receiving the cash over ceiling prices, the issue is whether you do or do not believe the testimony and the story told by the defendant in the case. If you believe his story, then you should return a verdict of not guilty. If you are convinced beyond a reasonable doubt that his story should not be believed, then you are justified in returning a verdict of guilty." (R. 483.)

The court repeatedly instructed the jury that it was their duty to pass on the facts in the case. The charge read as a whole amply advised the jury of the rights of the defendant, burden of proof, presumption of innocence, and elements of the offense. The charge clearly demonstrates that the trial judge scrupulously emphasized to the jury that it alone had the sole responsibility of determining the facts and judging the credibility of witnesses, and that the jurors were to disregard any comments or observations of the court bearing on this matter.

It is clear enough that in the federal courts, questioning and comments on the evidence by the trial judge are not *per se* beyond the bounds of judicial propriety. *United States v. Aaron,* 190 F. 2d 144 (C.A. 2d), certiorari denied, *sub nomine Friedus v. United States,* 342 U.S. 827; *Quercia v. United States,* 289 U.S. 466, 469; *Glasser v. United States,* 315 U.S. 60, 82; *Kettenbach v. United States,* 202 Fed. 377, 385

(C.A. 9th), certiorari denied, 229 U.S. 613; *Henry v. United States,* 273 Fed. 330, 340 (C.A. D.C.), certiorari denied, 257 U.S. 640; *Cusmano v. United States,* 13 F. 2d 451, 452 (C.A. 6th), certiorari dismissed, 273 U.S. 773; *United States v. Warren,* 120 F. 2d 211, 212 (C.A. 2d); *Simon v. United States,* 123 F. 2d 80, 82 (C.A. 4th), certiorari denied, 314 U.S. 694; *Todorow v. United States,* 173 F. 2d 439, 448 (C.A. 9th), certiorari denied, 337 U.S. 925. As succinctly stated by the Court of Appeals for the Fourth Circuit in the *Simon* case (p. 83):

> "It cannot be too often repeated, or too strongly emphasized, that the function of a federal trial judge is not that of an umpire or of a moderator at a town meeting. He sits to see that justice is done in the cases heard before him; and it is his duty to see that a case on trial is presented in such way as to be understood by the jury, as well as by himself. He should not hesitate to ask questions for the purpose of developing the facts; and it is no ground of complaint that the facts so developed may hurt or help one side or the other."

Appellant cites the recent case of *Olender v. United States* (9th Cir., 1954) 210 F. 2d 795, in support of his contention that the instruction given shifted the burden of proof from the Government to appellant. This court did not reverse the *Olender* case solely on the question of instruction. What this court said was:

> ". . . The challenged instruction, considered as a part of the lower court's charge as a whole, would not, in itself, be sufficiently prejudicial to

require a reversal, but it must be considered along with the other errors committed at the trial."

The appellant next contends that the instruction took from the jury the question of whether the Government's evidence established the charge beyond a reasonable doubt. (App. Br., p. 34.)

In a recent case, *Holland v. United States,* 209 F. 2d 516, decided January 21, 1954, the Court of Appeals for the Tenth Circuit had occasion to consider the question of reasonable doubt and stated, at page 522:

> "[11, 12] There are many definitions of 'reasonable doubt'. Some courts assert that the words themselves carry their own best definition and that any attempts at clarification or definition tend only to confuse an otherwise simple phrase. See 20 Am. Jur. Evidence, Sec. 1257; 53 Am. Jur. Trial, Sec. 751; 36 Words & Phrases, Reasonable Doubt, pp. 297, 319; Wigmore on Evidence, 3rd Ed., Vol. IX, Sec. 2497. Under the federal rule, however, the accused is entitled to a definition of the term 'reasonable doubt', and failure to instruct upon request has been held to constitute error. Nanfito v. United States, 8 Cir., 20 F. 2d 376; Blatt v. United States, 3 Cir., 60 F. 2d 481; Egan v. United States, 52 App. D.C. 384, 287 F. 958; Mundy v. United States, 85 U.S. App. D.C. 120, 176 F. 2d 32; Schencks v. United States, 55 App. D.C. 84, 2 F. 2d 185. But, a proper definition of the term does not depend upon the observance of a ritual or the use of precise words found in some accepted definition. United States v. Schireson, 3 Cir., 116 F. 2d 881, 132 A.L.R. 1157; United States v.

> Stoehr, D.C., 100 F. Supp. 143, affirmed, 3 Cir., 196 F. 2d 276. It is sufficient if the jury is given to understand that reasonable doubt as applied to the measure of its persuasion means a real or substantial doubt generated by the evidence or a lack of it; and that beyond a reasonable doubt means to a reasonable or moral certainty. Wigmore, supra, Sec. 2497.
>
> [13] While the Court's definition of 'reasonable doubt' may not be a model of clarity and conciseness, we think it does suffice to convey the legally acceptable meaning of the term."

Appellant's own opening brief, at page 13, shows that a profit of over $11,000 was derived on a carload of Old Mister Boston Rocking Chair whisky, even assuming appellant paid $25 per case over the ceiling and sold it at $60 per case. There was ample evidence for the jury to find that the Government's case had been established beyond a reasonable doubt.

Appellant also relied on the case of *Bihn v. United States,* 328 U.S. 633, to support his contention that the questioned instruction was erroneous. This case is distinguishable from *Bihn v. United States,* where the question was an entirely different matter. In the present case, the Government proof established beyond a reasonable doubt a profit of over $100,000 to appellant, and the only evidence in the record of the alleged bonus payments is the uncorroborated story of the appellant.[5]

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[5]In the first trial there was a sharp conflict of testimony because Gersh stated that the bonuses to him were in reality advances for him to purchase equipment for the appellant, which he did. *Wolcher v. United States,* 200 F. 2d 493.

The ultimate question in cases of this sort is whether the jury has been left free to perform its fact finding functions. The complained of instruction, read in the light of other instructions, was not objectionable or improper and, even standing alone, was a correct exposition of the law.

Appellant had conceded and admitted the prima facie elements of the Government's case—that he engaged in the sale of liquor in the black market, that sales amounted to something over $300,000, and that no part of the transactions was reflected on his books, which were the basis of his income tax return. Since that was admitted, then there is only one issue—was there a net profit derived? There was admittedly a profit derived so far as all available records of the transactions showed; i.e., the difference between the invoice price from the distributor and the retail sales price received by the appellant showed a profit of over $100,000, which, admittedly, was not shown on his income tax return and on which no tax was paid.

Clearly, if the case was to be decided on the admitted facts, appellant was guilty, unless there was additional expense which resulted in no profit being realized. The only evidence of any such admitted expense came from the unsupported word of the appellant himself. The only question remaining, after considering the admissions, was whether the appellant's story of his additional cost was believable, for, if it was not believed by the jury, at least to the extent of raising a reasonable doubt of guilt, *the admitted*

facts justified conviction. If it was believed, then, of course, the jury should acquit. The case was as simple as that, and that was what the instruction explained to the jury. Upon appraisal of the whole record and the instructions in this case, it is plain that the complained of instruction was well within the proper function of the trial court and that the remarks were in no way improper.

B. The Instruction Denied.

It is well settled that when a trial court gives all of the essential instructions a defendant is not entitled to any additional instructions. *Caminetti v. United States,* 242 U.S. 470.

The defendant in this case is charged with failure to report additional net income of $35,484.40. The Government does not have to prove the exact amount of the unreported income. *United States v. Johnson,* 319 U.S. 503, 507.

The question presented, therefore, is "Did the trial court's instruction properly cover the definition of net income?" If the court's instruction did cover the definition of net income, the requested instruction was properly denied. The court's definition of net income was as follows:

> "Now what do we mean when we speak about net income? Well, there is of course a very simple definition of it. Most of the men on the jury, I think, have heard it stated—maybe the ladies not so often, unless you are following some occupation—that it means the gross income, the total

income that a man has, less the deductions or expenses or expenditures that the law says he can take from it; then what he has got left is his net income. Now that's what the defendant is charged in this case with non-payment of, is the net income. Now the taxable income of an individual includes anything by way of a gain or profit or income that he might get from salaries or wages, business, compensation for personal services, from trade or business, or sales or dealings in property; and it also includes any profit or income, net in character, that [513] a man would obtain from any illegal transaction as well as a legal transaction. He has to account for all of his net income to the United States." (R. 481.)

* * * * * * *

"The defendant, on the other hand, admits that the black market transactions were had by the defendant, but contends that he made no profit in connection with these transactions and that therefore he had no net income and that therefore he is not chargeable with any evasion of income taxes; that he made no profit in the matter, because he had to pay out certain monies in connection with the transactions and that therefore the net result was that he had no profit in the matter, and that therefore he is not chargeable with a violation of federal statute. * * * If you believe his story, then you should return a verdict of not guilty." (R. 483.)

In the face of this instruction the jury could not, as suggested by Appellant (App. Br. p. 39) come to the conclusion that any money received by Appellant

over the invoice price constituted taxable income. It was made perfectly clear that Appellant's cost of the liquor should include any over-ceiling payments they might believe he had made.

It is apparent that taxable income, as involved in this case, was adequately defined by the court's instructions.

III.

THE DISTRICT COURT DID NOT ERR IN SUSTAINING OBJECTIONS BY THE GOVERNMENT TO QUESTIONS ASKED OF APPELLANT ON DIRECT EXAMINATION REGARDING APPELLANT'S CONVERSATIONS WITH WILLIAM GERSH IN THE SPRING OF 1943.

In point IV of his argument, based on specification of error No. 3, appellant contends (Br. 56-60) that the district court erred in excluding appellant's conversation with William Gersh in the Spring of 1943.

A short answer to appellant's argument is that the substance of the conversation with Gersh in the Spring of 1943 is in the Record at page 382, as follows:

> "Q. And in your first conversations with Mr. Gersh did you ask him to get any liquor for you or did he offer to get it for you?
>
> A. Well, I made the offer very easy. I mentioned the shortage of whisky here, and he told me that he knew—he had lots of friends in the liquor business, he could get it for [407] me.
>
> Q. That was the first time?
>
> A. I believe I brought up the conversation.

Q. Did you in that conversation tell him what you had just paid to get some liquor?

A. Yes, I did.

Q. What did you tell him?

A. I told him I had just paid——

Mr. Schnacke. If your Honor, please, I have sat back without objecting and all of the conversation has gone in——

The Court. Just make your objection.

Mr. Schnacke. I must object at this point.

The Court. It is a self-serving statement.

Mr. Schnacke. To this as hearsay and as a self-serving statement.

The Court. I will sustain the objection.

Q. (By Mr. Friedman) In your conversations with Mr. Gersh, who mentioned the over-ceiling price that should be delivered to Mr. Gersh?

A. He did.

Q. He did?

A. Yes, sir.

Q. He fixed that, is that correct?

A. Yes, he fixed it."

Mr. Wolcher's testimony in the first trial does not add to the substance of the above-enumerated conversation. (No. 12,992, R. 442.)

"Q. I see. And what else was said in that conversation?

A. I told him that I would—to line some up for me and I would be glad to get it.

Q. Yes? What did he say to that?

A. Said he would make an effort to do so.

Q. I see. Now was anything said about money at that time?

A. Yes, he said previously 'for that kind of money,' referring to the $20 a case that I had been paying, that I had paid over for the Old Brook whiskey. He said for that kind of money he could get me all the whiskey in the world.

Q. I see. Was anything said about where that kind of money was to be paid or to whom?

A. Yes.

Q. What did he say?

A. To him.

Q. To him?

A. He would make arrangements for me to get this whiskey.

Q. I see. Now as a result of that conversation did you deliver or pay or send to Mr. Gersh any money?

A. Yes, I did."

It is to be remembered that this case involved a charge of evasion of taxes by the appellant and that a showing had been made in the Government's case in chief that the appellant had engaged in a widespread black market liquor operation involving the sale of some 5138 cases of liquor at prices in excess of ceiling and invoice prices with part of the payments having been made by check to represent the invoice price and the over invoice price being paid in cash.

The appellant's contention at the trial was that he had made no profit on these black market transactions by reason of the fact that he had paid over to William Gersh all of the over ceiling money col-

lected by him in cash. In an effort to support appellant's contention at the trial appellant sought to introduce a conversation held between appellant and Gersh at some time during the spring of 1943. He was permitted to testify to the fact that there was a conversation between himself and Gersh and that pursuant to the conversation he had sent money to Gersh to acquire whiskey after which whiskey was delivered. (R. 358.) He testified to the details of receiving the liquor, to the amounts of money that he sent Gersh, that the money was paid to be applied against the overage of the whiskey, that is, the over ceiling price, that his arrangement with Gersh was to pay $20.00 a case over the invoice price in order to get whiskey until Gersh raised the price to $25.00 a case, that none of the money was transmitted to Gersh to pay any part of the invoice price of the whiskey, that various amounts of money had passed back and forth between appellant and Gersh. (R. 356-365.)

An objection was properly sustained to a question "and what conversation did you have with Mr. Gersh at that time" referring to an alleged conversation held between appellant and Gersh in the spring of 1943 before the first shipment of liquor was sent from the east. This question, of course, called for hearsay and self-serving declarations by appellant. What appellant may have stated to Gersh in the spring of 1943 certainly had no probative value in determining whether or not the tax return filed by

appellant in October of 1944 was or was not fraudulent, any more than does the alleged statements of Gersh made on the same occasion.

The issue in the case was not what agreement the appellant had or claims to have had with Gersh but was rather what he did in connection with any such agreement if he did anything. The appellant was attempting to prove that he had sent money to Gersh in payment of the over ceiling price on liquor. Quite clearly what might have been said during the course of an alleged conversation prior to the alleged shipments of money or of liquor was not probative of the fact that money had been sent or that liquor had been delivered pursuant to the payments of money.

Appellant's only suggested reason for the admissibility of this conversation is the bald statement that it was not hearsay. Quite clearly any extrajudicial statement reported in a judicial proceeding is hearsay. Under certain well settled exceptions it may be admissible hearsay, but the appellant has failed to point out any exception to the hearsay rule under which this conversation might be admissible.

The appellant cites the case of *Sparks v. United States* (6th Cir. 1917) 241 Fed. 777, 791 as authority for the proposition that the entire text of the conversation, rather than merely the fact that a conversation was held, is admissible in evidence. Appellant has overlooked the distinction between the conversation in the *Sparks* case and the conversation in the present case. In the *Sparks* case the issue before

the jury was the intent with which Sparks had done certain acts. He claimed that the acts were done with an innocent intent because a certain conversation had given him reason to think the actions were innocent. As the Court there said "the purpose of the offered testimony was to rebut fraudulent purpose." Wolcher's conversation with Gersh was offered in the present case for a far different purpose. The question here was not what may have *motivated* Wolcher's payments to Gersh but *whether or not any such payments were made.* While it is true that such a conversation might be admitted to show motivation, it is inadmissible hearsay on the question of whether or not money was actually paid to Gersh.

Moreover, this Court's opinion in the previous trial, *Wolcher v. United States,* 200 F. 2d 493, at par. 4, shows that there was a sharp conflict on the subject as to why the money was actually paid:

> "Gersh was called as a rebuttal witness for the Government and while he stated that in 1943 he had handled money belonging to Wolcher in amounts totaling $85,000, his version was that the money was sent to him to obtain coin machines for Wolcher. His testimony was that at that time coin machines were very difficult to procure, and that they could be bought only by cash payment in advance of the full purchase price. This, he said, was why Wolcher sent him these sums of money. He testified that he bought ten phonographs for Wolcher during this period, the purchase amounting to $5250, but that he had returned all the balance of the $85,000 to Wolcher."

It is clear that the conversation was not admissible, but in any event, to prolong discussion on the point is unnecessary, since the substance of the conversation is in the record despite the objection sustained.

IV.

THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN DENYING APPELLANT'S MOTION TO REOPEN THE CASE.

There is no merit to appellant's fourth specification of error. The Court did not err in refusing to reopen the case to allow appellant to call William Gersh as a witness. Appellant was fully aware of the fact that Gersh had been called as a witness at the first trial of the case and was fully aware, of course, of the testimony given by Gersh on that occasion. Appellant had every opportunity to place Gersh under subpoena and, as a matter of fact, appellant had seen Gersh within the year before the trial, received every week the magazine Cash Box published by Gersh and was aware of the fact that Gersh resided in the immediate area around Chicago. (R. 391.) Under these circumstances both the nature of Gersh's testimony and Gersh's whereabouts were as well or better known to appellant than they were to the Government and, if Gersh was thought to be an essential witness for appellant, there was no justification for appellant's failure to have Gersh under subpoena.

It is well established that the right to reopen a case, after the case has been closed, lies within the discretion of the trial court.

Horowitz v. United States, 12 F. 2d 590, certiorari denied, 273 U.S. 697 (5th Cir., 1926);
Brink v. United States, 60 F. 2d 231, certiorari denied, 287 U.S. 667 (6th Cir., 1932).

There is no abuse of the trial court's exercise of its discretion in refusing to permit a party to reopen its case where the party has full knowledge of the nature of the testimony and the whereabouts of the proposed witness in sufficient time to have placed such a witness under subpoena in order to enforce his attendance at the trial.

Alexis v. United States (5th Cir., 1904), 129 Fed. 60;
Kalen v. United States, 196 Fed. 888, (9th Cir., 1912);
United States v. Stimson, 52 Fed. Supp. 425 affim'd, 141 F. 2d 664;
Eyer v. Brady, 128 F. 2d 1012, certiorari denied 317 U.S. 679.

It is interesting to note that out of the hundreds of cases involving the question of the propriety of permitting or refusing to permit the reopening of the case by one or another of the parties, no case has been found in which the action of the trial judge, in which ever way his discretion happened to be exercised, has been questioned by an Appellate Court or found to be grounds for reversal.

Appellant apparently makes a point of the fact that appellant was not aware of the presence of the witness in San Francisco until shortly before the time the

request was made to have the case reopened to call him as a witness. This, of course, is no answer to the failure of the appellant to have obtained process to secure a known witness whose known testimony the appellant now claims was essential to the establishment of his case. There is no validity to appellant's suggestion that appellant had a right to rely upon the Government to call for the benefit of the appellant a witness whom the appellant deemed essential.

The Federal cases cited by appellant fail to support appellant's contention that there was any abuse of the trial court's discretion.

United States v. Maggio, (C.C.A. 3rd), 126 F. 2d 155,

is a case in which the exercise of discretion by the trial court was approved and it merely establishes the principle that the reopening of a party's case is proper where the party failing to call a witness had no sufficient prior opportunity to place the witness under subpoena. The court there said "* * * The fact that that testimony was not available to the Government until a few minutes before it was offered makes it clear that the court's action was quite proper."

The appellant makes considerable point of colloquy occurring during the course of which counsel for the Government expressed the opinion that some rebuttal witnesses would be called, (appellant's opening brief pages 52 and 53), but the brief fails to point out that

this conversation occurred after a representation by counsel for the appellant that at least one additional defense witness would be called (R. 453-4). It was only after the failure of appellant to call any additional witnesses that the prosecution rested.

The Government is under no obligation to call witnesses in order to have those witnesses available for the appellant. The case of *Sullivan v. United States,* 9th Cir., 32 F. 2d 992, cited by the appellant concerned a far different situation from the one present in this case. There the witnesses were in custody at a county jail and would have been returned to penitentiaries upon their release from Government subpoenas, and the case suggests the propriety of the Government advising the appellant of the fact that these witnesses were to be available only for a short time. However, that case dealt not with the propriety of reopening a case or of retaining government witnesses for the benefit of the other party, but rather the propriety of a comment by the prosecuting attorney in the presence of the jury to indicate to the jury that these witnesses were available to the defense.

The appellant has also cited the case of *Hayes v. Viscome* (Calif.) 122 A.C.A. 167. It is sufficient to point out that the circumstances of that case were substantially different from those in the present case. There, as the court stated, the party "could not have known this (that a certain witness had to be called) unless they had known that defendants did not intend to call him and to assume this would be to assume

that defense counsel knew that the doctor's testimony would be adverse."

No assumptions regarding the testimony of Gersh had to be made by appellant here. Gersh had been exhaustively examined and cross-examined at the first trial and the extent and necessity of his testimony were fully known to appellant long before the time within which witnesses should have been subpoenaed for the second trial. In view of the fact that the knowledge of the facts of the case by appellant's counsel, who had participated in the trial of the first case, was far superior to that of the prosecuting attorney, who had not, appellant's claim that there was a "suppression of evidence" on the part of the prosecutor, seems very hollow.

It is noted that appellant's opening brief and appellant's closing brief in the previous trial (No. 12,992) relies to some extent on the sharp conflict of testimony between Gersh and Wolcher. Appellant's closing brief (No. 12,992) at page 2 states:

> "It seems unnecessary to state further details concerning the conflicts of testimony between Gersh and Wolcher. It is sufficient to say that both witnesses were examined in great detail. In the light of the jury's verdict of guilty, it can only be assumed that they believed Gersh and disbelieved Wolcher."

It further states:

> "The foregoing statement is in strict accord with appellant's contention herein. The jury had to decide whether Gersh or Wolcher was testifying to the truth."

In view of the foregoing, there seems to be no merit to appellant's last specification of error, because in the previous trial the defendant and appellant's brief was based in substantial part, upon the contention that Gersh's testimony should not be believed by the court.

Now to contend to this court that Gersh's testimony would have fully corroborated the appellant's version of the facts and that this court should reverse the case for a second time because Gersh was absent seems without foundation in reason.

CONCLUSION.

For the reasons stated, it is respectfully submitted that the judgment and sentence of the trial court should be affirmed.

Dated, San Francisco, California,
June 1, 1954.

LLOYD H. BURKE,
United States Attorney,
ROBERT H. SCHNACKE,
Assistant United States Attorney,
MELVIN L. SEARS,
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(Appendix Follows.)

Appendix.

Appendix

SPECIFICATION OF ERROR NO. 1.

INSTRUCTIONS TO THE JURY. (R. 473-486.)

Now the part that you play here is to determine the question of fact that is presented. That's exclusively your function. In a criminal case the question of fact which a jury has to determine is, Is the defendant guilty or not guilty of the charge that is made against him? You have the final word in that regard. Judges do not interfere with that function. It sometimes happens that in some cases where it is deemed advisable, a judge may make some comment upon the evidence or its weight; if he does so to point out what he thinks is in the interest of justice, and a matter of importance to be called to the attention of the jury. But even in such cases the jury is in no way bound by the comment of the judge and should come to its own conclusion with respect to such matters. I mention that because I may make one comment concerning the evidence in this case.

You are not to conclude from anything that I may have said during the course of this trial that I was intending to indicate to you in any way what your verdict should be. A judge is called upon to make rulings on evidence, at times to admonish witnesses, and at times he may propound some interrogatories himself to witnesses. But those actions on the part of the judge are not for the purpose of conveying any intimation to the jury as to what its verdict

should be, but only pursuant to the court's power and indeed its duty to supervise the trial of the case and to expedite it where possible. So you cannot obtain from me in this case any indication of what I think your verdict should be. Some jurors hopefully look for such hints—they just think, maybe, that makes their task somewhat easier. But you have no such hints from me and you must make your decision yourselves.

Now the judge has the duty of telling you what the law is for the purpose of assisting you in appraising the testimony, so that you may come to a just conclusion. In that field the Judge is supreme, just as you are in the field wherein you alone may make the decision as to guilt or innocence. You have to assume, rightfully or wrongly, that the judge knows what he is talking about when he tells you what the law is, and you have to follow that. I state that to you because some men and women do come into a jury box with some preconceived notions upon social and economic theories, and sometimes legal theories, and they say, "Well, I think the law should be so and so, and so I am going to decide the case that way." That is not permissible and in fact it is wrong, because we have found that it is not in the interest of justice that that be done. It is not the function of the jury; therefore, you must accept what statements of law the judge makes to you as final and binding upon you.

Now while we have somewhat different functions to perform—you deciding the guilt or innocence of

the defendant and the judge advising you as to the law in order to help in your decision, nevertheless we are in a sense a team, because while we have different functions to perform, we both of us—that is, the jury and the judge—have the same objection, and that is to accomplish justice. That is what we are here for.

Now in your deliberations in this case it is your duty to exclude all considerations of either prejudice or sympathy. You cannot render a verdict because of any sympathy for the defendant, and likewise you cannot render a verdict against him because of any prejudice connected with the evidence in the case. Both of those matters must be excluded in your deliberations. You should not concern yourself with the matter of the punishment of the defendant in the event he is found guilty, because the matter of punishment is reserved by law exclusively for the judge who presides in the case.

Now this is an important case, ladies and gentlemen. It is a serious case to both the Government and the defendant. Indeed it may be said that all cases wherein the life, liberty or property of individuals are at stake are serious and important cases. And so this is for that reason an important case. There are a few general rules that are applicable to all criminal cases that may help you in arriving at a decision in this case. I shall give you a few of them, very briefly and perhaps somewhat colloquial.

I have followed the practice for a number of years of not reading instructions to juries, long-winded legal, technical statements. I have an abiding conviction that a judge should talk to a jury in simple language, because the jury is brought in, as it were, from the streets to the courtroom. It is not familiar with technical language. A judge should talk to the jury in the language that jurors use in their everyday activities. And so what I have to say to you may not read very grammatically hereafter, but I think you will understand it better than if I were to give you a lot of technical, highfalutin' explanations of matters that are really quite simple.

I told you when you were impaneled that there was no presumption that arises because the Grand Jury filed an indictment in this case, that the defendant is guilty of the charge. I repeat it to you now. There is no such presumption. To the contrary, the presumption is that the defendant is innocent and that presumption continues until such time as the Government has proved the guilt of the defendant beyond a reasonable doubt. The Government has the burden of proving the guilt of the defendant. That burden never shifts at any stage of the proceeding to the defendant. The defendant has no obligation of any kind to go forward and prove that he is innocent —as is true in some continental systems of law.

Now I have told you that the Government must prove that the defendant is guilty beyond a reasonable doubt before you may find such a verdict. Now what

do we mean when we say, "Beyond a reasonable doubt"? The explanation that I give juries is a very simple one, I think, and that is that a reasonable doubt is a doubt that is based upon reason. It is a doubt that arises as a result of you using your heads, your thinking processes. It is not a doubt that's imaginary or speculative or captious—something that you sort of reach up into the sky to get. It is a doubt that results after you have put your minds to the task of deciding the case. It is the kind of a doubt that you would have if you were called upon to decide some very important and vital matter in your own lives, and you hesitated and paused before you made your decision. That's the kind of a doubt that we speak of as a reasonable doubt. It might be stated somewhat differently by saying that if you were in doubt to this extent, that you could draw some inference of guilt as well as an inference of innocence from the facts in the case, that of course in such a case you should draw the inference of innocence, because then you wouldn't be convinced beyond a reasonable doubt by the evidence in the case.

Now whether or not you believe the witnesses who have testified in this case and the weight that you wish to give to their testimony respectively is a matter for your exclusive decision. We start out in every case with the presumption that when somebody comes up and sits in this chair and takes the oath, that he is going to tell the truth. However, that presumption can be negatived or rebutted by a number of things.

It can be negatived by the manner in which the witness testifies, by the demeanor of the witness on the witness stand, by whether or not the witness contradicts himself, whether he is contradicted by the testimony of other witnesses, by the interest that he has in the case, by his relationship to one side or the other in the case; you can determine the credibility of the witness by all of these things, including the witness' criminal record, if any. And it is upon the basis of all of those factors that you determine how much weight you may give to the testimony of a witness. In addition you may consider—and it is important—whether or not the witness has testified falsely in any material respect. If it seems to you clearly that a witness has made a false statement in some material matter, then you can throw out and disregard all of his testimony, and you don't have to give any credence to anything that he said. That, however, is dependent upon whether or not you have concluded that he has testified falsely in some material matter.

Now it is your duty to disregard any testimony that the court has stricken or any testimony in the case where an objection to a question has been sustained.

I call your attention to the fact that the lawyers have argued this case to you. That's their right and indeed their duty to their respective clients and principals. If it should appear to you that there is any discrepancy between the statement of facts made by the lawyers in their argument and the evidence as you recall it as having been given by the witnesses,

then you will throw out and disregard the testimony as stated to be the testimony by the lawyers and take into account only the evidence as you recall it as having been given by the witnesses themselves.

Now you should use your good sense, your common sense in deciding this case. You are not, as one of my older colleagues once said, to leave your common sense outside and check it in some room; you bring it in here with you and you use it. You should resolve the case with a calm and deliberate and cautious judgment in the light of your own understanding and knowledge of how human beings act and conduct themselves. You should remember at all times that the defendant is entitled to any reasonable doubt that you may have in your minds, but at the same time you should remember that if you have no such doubt, then the Government is entitled to a verdict.

The defendant in this case has testified in his own behalf for himself. That being so, you will judge his testimony the same as the testimony of any other witness, applying the standards that I already have given you. In addition, and in the case of a defendant, you may consider his interest in the case, his hopes and his fears and what he has to gain or lose by whatever verdict you may render.

Now the issue in this particular case, Members of the Jury, in my opinion, resolved itself down, as frequently happens, to perhaps what may be colloquially said to be a rather simple question. The indictment in this case charges the defendant with wilfully and

knowingly attempting to defeat and evade a large part of his income tax for the fiscal year ending June, 1944. The amount by which his net income is alleged to have exceeded the amount he reported on his return was approximately $45,000, as alleged in the indictment. The indictment was filed pursuant to a federal statute which makes it a criminal offense for any person to wilfully attempt in any manner to evade or defeat any tax imposed by the revenue laws of the United States. Now the defendant plead not guilty to that charge, and so that's the issue. Did he wilfully and intentionally attempt to evade the payment of income taxes due the United States for this fiscal year ending in June, 1944?

Now the Government has the burden of proving that the defendant had taxable net income which he did not report, and that his act in so doing, failing to report it, was wilful and intentional.

Now what do we mean when we speak about net income? Well, there is of course a very simple definition of it. Most of the men on the jury, I think, have heard it stated—maybe the ladies not so often, unless you are following some occupation—that it means the gross income, the total income that a man has, less the deductions or expenses or expenditures that the law says he can take from it; then what he has got left is his net income. Now that's what the defendant is charged in this case with non-payment of, is the net income. Now the taxable income of an individual includes anything by way of a gain or

profit or income that he might get from salaries or wages, business, compensation for personal services, from trade or business, or sales or dealings in property; and it also includes any profit or income, net in character, that a man would obtain from any illegal transaction as well as a legal transaction. He has to account for all of his net income to the United States.

Now whether or not the act of failing to account for and the evasion of income tax payments is wilful or not is to be determined from all of the evidence in the case. It is not necessary for the Government to prove directly wilfulness. It may be inferred from all of the evidence in the case, including the acts and declarations made by the defendant and any other acts, circumstances in the evidence which relevantly bear on the question of the state of mind or intention of the defendant.

Now it is not necessary for the Government to prove the exact amount of the evasion, if any, nor the exact amount charged in the indictment. It would be sufficient if the Government shows that a substantial amount of money, consisting of net income, was wilfully evaded by the defendant in the case.

Now I think it might be well if I very briefly stated to you what the Court believes is the issue of the case as it appears from the contentions respectively of the parties—the Government on the one hand and the defendant on the other hand. The Government contends, as appears from the argument made by

Government counsel, that the cash monies that the Government proved the defendant received from the sale of liquor and which the defendant admitted that he received, were income and were net income, and that the whisky was purchased for the purpose of making a profit on it in its resale and not for the benefit of the defendant's own taverns, or his friends'. The Government contends that there were no records of the transaction kept by the defendant, and that that was so that he could keep the proceeds without paying any tax on them. The Government contends, that there were no records of the transaction kept by the defendant, and that that was so that he could keep the proceeds without paying any tax on them. The Government contends, as stated by the Government lawyer, that the defendant's account of sending large amounts in cash through the mail and otherwise to someone in the East is a story that is fabricated and should not be believed by you. That, I think very briefly, is the Government's contention.

The defendant, on the other hand, admits that the black market transactions were had by the defendant, but contends that he made no profit in connection with these transactions and that therefore he had no net income and that therefore he is not chargeable with any evasion of income taxes; that he made no profit in the matter, because he had to pay out certain monies in connection with the transactions and that therefore the net result was that he had no profit in the matter, and that therefore he is not chargeable with a violation of federal statute.

So that in my opinion brings the issue of the case down to a very simple, and that is this—that since the Government has proved and the defendant has admitted receiving the cash over ceiling prices, the issue is whether you do or do not believe the testimony and the story told by the defendant in the case. If you believe his story, then you should return a verdict of not guilty. If you are convinced beyond a reasonable doubt that his story should not be believed, then you are justified in returning a verdict of guilty.

The defendant is not on trial in this case for violations of the price ceilings. The evidence shows in this case that he had already plead guilty to a charge brought in this court, and therefore he is not on trial again for that same offense. You may, however, take into account in determining whether or not there was an evasion of payment of income taxes, the nature of the transactions, the illegality of the transactions involved and also the matter of the failure to keep records and to enter these transactions on his books. Those are factors which you can take into account and which the Court considers are important factors to take into account in determining whether or not there was a violation of the law.

The last comment that the Court has made is not in any way binding upon the Jury. I am merely pointing out to you what in the opinion of the Court are important questions to be determined in connection with the resolution of the issue of guilt or innocence of the defendant. You are not bound by them

in any way and you come to your own conclusion in the matter. If you regard them as not important, you won't hurt the Court's feelings at all in coming to a different conclusion, because that is entirely your function, and you make your own decision in the case.

I want to call your attention before I conclude to the fact that you are not to take into account the fact that there has been any previous trial in this case, except insofar as there was reference to the testimony or records introduced in this case, that were referred to as having been introduced in another case. But what the outcome of the other case was and why it is being retried now is not a matter that you take into account either for or against the defendant in this case. You judge this case solely and exclusively upon the basis of the evidence that has been presented here.

Now, ladies and gentlemen, I think I have given you about all the advice and information that I think will be of help to you. If you can conscientiously do so, you are expected to agree upon a verdict in this case. The defendant is entitled to the independent judgment of each one of you when you go to the jury room to deliberate. However, you should freely consult with one another in the jury room. If any one of you should be convinced that your view of the case is erroneous, you shouldn't be stubborn and you shouldn't hesitate to abandon your own view under such circumstances. However, on the other hand, it

is entirely proper to continue to adhere to your own view if, after a full exchange of ideas, you believe that you are right. Whenever all of you have agreed to a verdict, it is the verdict of the jury. Your verdict must be unanimous. You should not return to the courtroom with a verdict unless in the jury room all of you have agreed to it.

When you retire to deliberate, you will select one of your number as foreman or forelady, as the case may be, and he or she will preside over your deliberations in the jury room and will represent you in the further conduct of this case here and will sign your verdict for you when you have agreed upon it.

We have prepared a form of verdict for you. It is very simple. It reads: "We the Jury find Louis E. Wolcher, the defendant at the bar, (blank) as charged in the indictment." In the blank space you will write the words "guilty" or "not guilty", in accordance with the conclusion which you come to; and when you do that, your foreman will sign the verdict and that will be your verdict.

After you have retired to deliberate and have organized, selected a foreman and at any time that you wish thereafter to see any of the exhibits that have been introduced as evidence in the case, send word through the bailiff and the court will see that they are sent to you.

Are there any suggestions that counsel wish to make?

Well, Members of the Jury, it may be that I may want to either add something to what I have said to you. I want to consult with the lawyers about that first. So I will now ask you to take a brief recess. But bear in mind that the case is not yet submitted to you. You are still under the admonition not to talk about it among yourselves or to let anybody talk to you about it, and you should still not form or express any conclusions in the matter. I will keep you out just a brief time and bring you back and let you know whether or not the instructions are complete.

Will you take the Jury out?

No. 14,109

IN THE

United States Court of Appeals

For the Ninth Circuit

LOUIS E. WOLCHER,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the District Court of the United States for the Northern District of California.

APPELLANT'S CLOSING BRIEF.

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APPELLANT'S CLOSING BRIEF.

Appellee in an attempt to support the judgments herein has made several references to and quoted from the record on the prior appeal (Ap. Br. 6, 8, 9, 17 and 31). These references to and quotations from the prior record, even if competent and material to the appeal now before the Court, do not support appellee's position but, on the contrary, are additional reasons why the judgment herein should be reversed.

However, as appellee has seen fit to refer to the prior record we shall take the same liberty once or twice in the course of this brief.

On pages 7 and 8 of appellee's brief, undoubtedly for the purpose of emphasizing appellee's contention

that Wolcher's testimony was unbelievable and fantastic, appellee states as follows:

> "He also testified that he sent money to Gersh in many different ways: by check, by cash through the mail, by express, by delivering it to Gersh personally, and by 'just stuffed the money in an envelope without registering it.' "

But Gersh at the first trial corroborated Wolcher in the foregoing matters; he testified that he received $85,000 from Wolcher (No. 12, 992, R. 575); that with the exception of two checks all the money was returned to Wolcher in cash (R. 580); that he just put the currency in an envelope and mailed it back to him (R. 603); "Because I remember most of those transactions were in cash. He sent me, always sent me cash, * * *". (R. 607.)

On page 10 appellee argues:

> "To have a story which was at all plausible, Wolcher had to explain the fact that Gersh sent him money in large amounts. The jury had the right to consider the improbability that a man of Wolcher's resources and with thirty years business experience would send a large amount of money across the continent, have it returned to him, and send it back again—*all for the asserted purpose of not making a record*—when he was establishing such a record in the process." (Italics ours.)

The foregoing can only refer to the checks that were sent back and forth between Wolcher and Gersh, the cash sent by Wolcher could not establish any record.

Wolcher explained fully the exchange of checks; he testified that whenever he sent Gersh a check, such check became a record; that to wipe out this record by a cross-item he would subsequently send to Gersh in cash an amount to equal the check and then Gersh would send him back such amount by check and thus the items would cancel each other on his books. (R. 363-4, 380.)

Next, appellee on page 10 states: "Appellant did not call Gersh as a witness". Gersh was a witness adverse to appellant; at the first trial he was called by the Government and, while admitting receipt of $85,000 from Wolcher, denied that such money was sent or delivered to him for the purpose of his procuring whiskey for Wolcher (see opinion of this Court on the prior appeal). Appellant was fully justified in believing the Government would again call Gersh as a rebuttal witness and it was not until the Government rested that appellant knew Gersh was not to testify.

THE COURT ERRED IN INSTRUCTING THE JURY THAT APPELLANT'S GUILT OR INNOCENCE DEPENDED ON THE TRUTH OR FALSITY OF HIS TESTIMONY.

Before answering appellee's argument, that the Court did not err in instructing the jury that if the jurors believed appellant's story they should acquit but if they were convinced beyond a reasonable doubt that his story should not be believed they would be justified in convicting appellant (R. 483; Appellant's

Op. Br. p. 14), we desire to cite a few pertinent authorities in addition to the decision of this Court in *Olender v. United States*, 210 F. 2d 795.

In *Ward v. United States*, (5 Cir.) 96 F. 2d 189, defendant was charged with the illegal possession and transportation of whiskey. The Court held the charge to the jury to be erroneous, stating (p. 192):

> "We think, too, that the point against the charge is well taken. As given, it had the effect of requiring defendant to convince the jury that he was not, instead of requiring the United States to convince them that he was, guilty under the statute. It was no sufficient compliance with appellant's request for a correcting charge, that 'if the jury had a reasonable doubt from the evidence as to whether or not the defendant possessed intoxicating liquor for the purpose of sale, they should acquit him,' for the court to state, as it did, 'I have already charged upon reasonable doubt in general terms.' The court should have modified its charge as given to advise the jury that while proof of the possession of whiskey, in tax-unpaid containers, standing alone made out a prima facie case, yet if upon all the evidence the jury had a reasonable doubt as to whether the possession was for a prohibited or a nonprohibited purpose, they should acquit him."

In *Balman v. United States*, (8 Cir.) 94 F. 2d 197, defendant was convicted of possessing furs stolen from an interstate commerce shipment. The Appellate Court states the portion of the complained of instruction as follows:

"The second and final assignment of error to the court's charge is of greater seriousness. The portion challenged is the following: 'Knowledge of the defendant that the pelts were stolen may be proved by circumstantial evidence; that is, by the facts and circumstances surrounding the transaction involving the pelts from which inference of guilty knowledge necessarily would follow. Proof that the defendant was in possession of property recently stolen raises a presumption of guilty knowledge in the absence of an explanation, and *it is for you to determine whether the defendant's explanation given by him in this case is sufficient to overcome the presumption; that is, it is for you to determine whether you believe the defendant's explanation of the trunk containing the furs being in his residence.*'" (Italics ours.)

The Court of Appeals gives a lengthy dissertation on the vice of such instruction holding (p. 199) that the effect of such instruction was "to impose the burden upon defendant to prove his innocence".

In *Boatright v. United States,* (8 Cir.) 105 F. 2d 737, where defendants were charged with a scheme to defraud, the Court instructed the jury as follows:

"The court also charged the jury as follows: 'On the other hand, if you should find and believe from the evidence in this case that these defendants did not devise an artifice or scheme to defraud; that they did not make false and fraudulent representations or pretenses; that if such were made there was no intention on their part to defraud, and no intention on their part

to obtain money or property by means of the representations made, then it would be your duty to find either one or both of them not guilty, according to what you believe, or either one of them, according to what you believe, if they were without fraudulent intent.' "

In holding the foregoing instruction to be erroneous, the Court of Appeals held as follows:

"The defendants complain that this shifted to them the burden of proving their innocence. It was, of course, incumbent upon the Government to prove every essential element of the offense charged. Unless the Government thus established the guilt of the defendants beyond a reasonable doubt, they were entitled to an acquittal. *But this instruction placed upon the defendants the burden of convincing the jury that they did not devise a scheme, that they did not make false representations, that they did not intend to defraud, that they did not intend to obtain money by false pretenses.* The instruction, we think, was erroneous." (Italics ours.)

In *Lambert v. United States,* (5 Cir.) 101 F. 2d 960, defendant was charged with selling and conspiring to sell narcotics. Contained in footnote 2 on p. 964 is an instruction given to the jury which concluded as follows:

"On the other hand, if you feel, after weighing all of the evidence that has been presented by both sides, that that of the defense outweighs or is equally balanced with that offered by the Government, after applying the law as given to

you by the Court, then you should acquit, but if it fails to balance or equal that offered by the Government and there is not that reasonable doubt about which I have spoken, then it is your duty to find the defendant guilty as charged."

Though no assignment of error was taken to this charge, the Appellate Court considered the question and held as follows (p. 964):

> "In the event of another trial, though no point was made upon it, we think we should call attention to a palpable error in the charge, upon the question of reasonable doubt. It is erroneous because it in effect requires the defendant to acquit himself, rather than requiring the Government to convict him. Subject to only one interpretation, it could have had only one effect upon the jury to have them believe that it was the defendant's duty, by his evidence, to raise a reasonable doubt as to his guilt, and that unless his evidence did so, he should be convicted. Instead, in short, of requiring the Government, by its evidence, to establish defendant's guilt, beyond all reasonable doubt, thus putting the burden on it to convict defendant, the charge required the defendant, by his evidence, to raise a reasonable doubt in his favor, and thus put upon him the burden of acquitting himself as innocent."

Appellee seeks to uphold the giving of the instruction on several grounds which we now discuss.

First, appellee argues that the Court repeatedly instructed the jury that it was the jurors' duty to pass on the facts and that the judge amply advised the

jury as to the burden of proof, presumption of innocence and elements of the offense.

In each of the cases cited above, as did the Court in the *Olender* case, *supra,* the trial judge instructed the jury as to the burden of proof, presumption of innocence, reasonable doubt and the elements of the offense, yet in each case it was held the giving of an instruction was error which in effect, if not in substance as did the instruction herein, told the jury that the burden was on the defendant to establish his innocence or that the guilt or innocence of defendant depended on the truth or falsity of his testimony.

Next, appellee argues that the Court had a right to comment on the evidence. We have no quarrel with this rule but the right to comment on the evidence does not vest the Court with the power or right to tell the jury that their finding as to the truth or falsity of defendant's testimony is sufficient to justify them in returning a verdict of guilty or not guilty as the case may be. If a judge's comment on the evidence is unfair, biased, prejudiced against the defendant or omits material parts of the testimony favorable to the defendant or authorizes the jury to ignore competent evidence in the case and to decide the case on a fractional part of the evidence, then error results despite the fact that the Court has the right to comment on the evidence. (*Boatright v. United States, supra,* at p. 739.)

Appellee then states "there was ample evidence for the jury to find that the Government's case had

been established beyond a reasonable doubt". The question involved here is not whether there was ample evidence to justify the verdict but whether that verdict was arrived at according to law and under proper judicial guidance. If there was not proper judicial guidance, then the verdicts cannot be supported. (*Bollenbach v. United States,* 326 U.S. 607, 612.) However, the instruction in the present case did not leave to the jury the determination of whether the Government's case had been established beyond a reasonable doubt. The instruction authorized the jury to disregard all the evidence in the case except the testimony of appellant and to decide his guilt or innocence according to whether they believed or disbelieved his testimony.

Appellee then argues that "the only evidence in the record of the alleged bonus payments is the uncorroborated story of the appellant". Under the complained of instruction, it became immaterial whether Wolcher's story was corroborated by other circumstances in the case as the instruction told the jury to determine the ultimate issue upon Wolcher's testimony. In our opening brief (pp. 34-36) we have pointed out ample evidence in the record consisting of facts from which the jury would have been justified in inferring (a) that Wolcher's testimony was corroborated and (b) that the Government's case had not been established beyond a reasonable doubt.

The Court's instruction undoubtedly swayed and controlled the deliberations of the jury. As stated

by the California Supreme Court in *People v. Choynski*, 95 Cal. 640, 643, 30 Pac. 796:

> " 'The experience of every lawyer shows the readiness with which a jury frequently catch at intimations of the court, and the great deference which they pay to the opinions and suggestions of the presiding judge, especially in a closely balanced case, when they can thus shift the responsibility of a decision of the issue from themselves to the court; a word, a look, or a tone may sometimes in such cases be of great or even of controlling influence. A judge cannot be too cautious in a criminal trial in avoiding all interference with the conclusions of the jury upon the facts.' "

Here, the instruction was the guiding star by which the jury shaped its course and this is made manifest by the verdict. The jury only considered Wolcher's testimony in determining his guilt and did not consider all the other evidence in the case; this is demonstrated by the fact that the jury appended the following to its verdict: "THE JURY RECOMMENDS LENIENCY." (R. 6.) The jury would hardly have made such recommendation unless they believed that outside of Wolcher's testimony there was evidence that created a grave doubt as to his guilt, but that under the Court's instruction they could only consider Wolcher's testimony.

THE COURT ERRED IN REFUSING TO GIVE DEFENDANT'S REQUESTED INSTRUCTION NO. 21.

This instruction in substance would have told the jury that in computing the cost of the whiskey to Wolcher, the jury should include in that cost any bonus or commission paid by Wolcher for procuring the whiskey.

Appellee attempts to justify the refusal to give this instruction on the ground that the Court fully instructed the jury as to what constituted net income. Appellee on pp. 19 and 20 of its brief sets forth the instructions it claims covered this situation. Nowhere in the Court's instruction is there any mention or reference made to any bonus or commission paid for the procurement of the whiskey. In defining net income the Court stated that it means "the total income that a man has, less the deductions or expenses or expenditures that the law says he can take from it". (R. 481.) Then the Court on p. 483 told the jury that the defendant admitted the black market transactions "but contends that he made no profit in connection with these transactions and that therefore he had no net income * * * because he had to pay out certain moneys in connection with the transactions".

As we argued in our opening brief (pp. 38-39), Mr. Haywood, the Internal Revenue Agent, testified that in computing the profit made by Wolcher on the whiskey transactions, that he "made no allowance for any deductions except the ceiling price of the whiskey". Under this state of the record, the Court's instructions should have been specific that any bonus

or commission or fee paid to procure the whiskey, over and above the ceiling cost thereof, had to be considered as part of the cost. With the testimony of Haywood in mind and under the instructions as given by the Court, the jury undoubtedly concluded that any payment of bonus or commission was illegal and could not be charged as part of the legal cost of the whiskey. Though we have made no point of it on this appeal, we submit the Court's instructions as to net income and taxable income were most confusing. They will be found in the appendix to appellee's brief at pp. viii to ix.

THE COURT ERRED IN NOT GRANTING APPELLANT'S MOTION TO REOPEN THE CASE.

Appellee advances several sophistical arguments to support the Court's action in refusing to reopen the case, so appellant could subpoena and produce Gersh as a witness solely for the purpose of having him identify the bank records of his account with the Corn Exchange Bank.

First, appellee states that the reopening of a case lies within the discretion of the trial Court. This proposition we have admitted in our opening brief; but whenever a matter lies within the discretion of a trial Court *there can be an abuse of that discretion.* Where the Court abuses its discretion to the prejudice of a litigant, such abuse of discretion is subject to review and warrants a reversal of the judgment.

(*Langnes v. Green,* 282 U.S. 531, 541, 75 L. ed. 520, 526.)

A criminal trial involves the liberty and property of a defendant and many times his very life. Such trial is not a game depending on various moves by Court and counsel. A criminal trial is the means sanctioned by law for the ascertainment of an accused's guilt or innocence, and in such trial the accused must be afforded every legitimate and legal means for proving his innocence.

> "It is certainly the policy of the law that one accused of crime shall have every opportunity to prove his innocence; * * * its policy demands that the accused shall have the fairest and fullest opportunity to make clear his innocence."
>
> *Atwell v. United States,* (4 Cir.) 162 Fed. 97; *Sunderland v. United States,* 19 F. 2d 202, 216.

The proof of Wolcher's innocence involved proof of his payment of the money to Gersh. To present a full defense it was necessary to establish the receipt by Gersh of this money. Wolcher had the right to rely upon and believe that the prosecution would call Gersh as a rebuttal witness as it had done at the first trial of the action.

In our opening brief we adopted as our argument the decision of the California Court in the case of *Hayes v. Viscome,* 122 A.C.A. 167, 264 P. 2d 173. Appellee seeks to make short shrift of this decision by stating on p. 30 of its brief as follows:

> "It is sufficient to point out that the circumstances of that case were substantially different from those in the present case. There, as the court stated, the party 'could not have known this (that a certain witness had to be called) unless they had known that defendants did not intend to call him and to assume this would be to assume that defense counsel knew that the doctor's testimony would be adverse.' "

The foregoing language of the California decision, so quoted by appellee, is preceded by the following statement of the Appellate Court:

> "The Court stated to counsel that they should have known much earlier that they would have to call Dr. Berryman".

This is exactly what the trial judge here told appellant. The California Court held that for the plaintiff to have known that they would have had to call Dr. Berryman rested upon two assumptions; first, that plaintiff knew that defendants did not intend to call the doctor and second, that to impute such knowledge to plaintiff would be to assume that the defense counsel knew the doctor's testimony would be adverse.

In the instant case Wolcher did not know that the Government did not intend to call Gersh as a witness and had no reason to assume that Government's counsel knew that Gersh's testimony would be adverse to the Government. Gersh's testimony as given at the first trial contradicted Wolcher's testimony as to the purpose for which the money was sent by Wolcher

to Gersh. Therefore Gersh's testimony would not have been adverse to the Government. At the first trial Gersh was the main witness for the Government on the question of the payment of the money. His testimony covered 82 pages from pp. 557 to 639.

Wolcher's endeavor to call Gersh was not for the purpose of examining him in detail as to his dealings with Wolcher but was solely for the purpose of establishing what had been a Government's Exhibit at the prior trial, to-wit, the record of the Corn Exchange Bank as to Gersh's bank account. Wolcher and his counsel never for a moment were led to believe that this bank account could not be established and it is quite significant that the agent in charge of the entire investigation, resulting in the indictment, testified he had no knowledge of this bank record although it had been produced by the Government at the first trial.

Appellee states it is interesting to note that out of the hundreds of cases involving the propriety of permitting or refusing to permit the reopening of a case, that no case has been found in which the action of the trial judge has been found to be grounds for reversal. (p. 28) It is likewise of interest to note that practically all of the reported cases involved the exercise of the Court's discretion *in permitting the case to be reopened for further evidence. Few judges have ever refused to allow a case to be reopened for further evidence where the proffered testimony was*

material to the sustaining or refuting of an ultimate issue in the case.

Appellee on p. 31 states that appellant's counsel had a superior knowledge of the facts to that of the prosecuting attorney. This statement is incorrect. The prosecuting attorney had the record of the prior trial and the entire file of the Government's agents who had investigated the case.

On Monday, August 31st, at ten o'clock in the morning, Wolcher attempted to establish Gersh's ledger account with the Corn Exchange Bank. In this he was unsuccessful. When he returned to Court at one o'clock that afternoon he advised the Court he had just learned that Gersh was in San Francisco and asked for a reasonable continuance in order to subpoena Gersh so that he could identify the bank account. The Government admitted that Gersh had been under subpoena and had arrived in San Francisco the previous night. Without laboring this point any further, we submit that fairness and justice demanded that Wolcher be given a reasonable opportunity to produce Gersh and thus establish the identity and validity of a document that was so vital to his defense. The action of the Court in denying this reasonable and fair request constituted an abuse of discretion that deprived Wolcher of a fair trial.

THE COURT ERRED IN NOT ALLOWING APPELLANT TO TESTIFY AS TO HIS CONVERSATION WITH GERSH.

Appellee states that a short answer to our argument on the above subject is that the substance of the conversation with Gersh is in the record at p. 382 and then quotes therefrom. It will be noted that these four questions and answers do not narrate the conversation at all. They merely give a short substance thereof which amounts to no more than the opinion and conclusion of the witness. The materiality of the entire conversation has been pointed out in our opening brief from pp. 56-60.

Appellee claims that the called for conversation was hearsay. We cited the case of *Sparks v. United States,* (6 Cir.) 241 F. 777, 791, as authority for the proposition that the called for conversation was not hearsay and that the jury were entitled to know all of the facts and circumstances surrounding the dealings between Wolcher and Gersh, including the conversation that led up to the payment of any money by Wolcher to Gersh.

Appellee attempts to distinguish the *Sparks* case on the ground that the issue there was the intent with which Sparks had done certain acts. Defendants in the *Sparks* case were charged with using the mails in furtherance of a scheme to defraud depositors of a bank. This involved fraudulent intent. Here Wolcher is charged with evading income taxes. This also involves fraudulent intent.

Appellee then states "the question here was not what may have motivated Wolcher's payments to

Gersh, but whether or not any such payments were made''. (Appellee's Brief, p. 26.) Then appellee argues that the conversation might be admitted to show motivation but it was hearsay on the question of whether or not money was actually paid to Gersh. Such argument destroys itself. As the question was whether or not any payments were made to Gersh, it became most material to establish an understanding or agreement between Wolcher and Gersh as to the payment of such money. We know of no other way this could have been done except by narrating the conversation. Appellee states this would have been hearsay testimony and such was the attitude of the trial judge, but the mere fact that the testimony is hearsay does not render it inadmissible. Hearsay is admissible and competent evidence if it forms part of the *res gestae.* The question of what constitutes the *res gestae* has been many times before the Court and under the rulings announced the conversation in its entirety was admissible.

In *Yarbrough v. Prudential Insurance Company,* (5 Cir.) 99 F. 2d 874, the Court lays down the rule as to what constitutes *res gestae* so far as the admission of conversations is concerned. The trial involved an insurance policy and whether it was delivered by the company to the insured. The insured died a day or two following the issuance of the policy. The widow of the insured and two others attempted to testify as to what the insured had said when he brought the policy home. The Court of Appeals held as follows:

"Are the statements of these three witnesses relevant evidence to come in along with the main facts as parts of the res gestae?

Res gestae must spring from the main fact; it presupposes a main fact and it means the circumstances, facts and declarations which grow out of the main fact, are contemporaneous with it, and serve to illustrate its character. 'One peculiarity of the main fact or transaction ought to be noted, and that is that it is not necessarily limited as to time—it may be a length of time in the action. The time of course depends upon the character of the transaction * * *'. *Mitchum v. State of Georgia,* 11 Ga. 615.

Here the main fact was the delivery of the policy in question. It came into possession of the insured on June 2, and he was drowned on June 4, 1937. The appellee had been permitted to testify that such delivery was for inspection only, and each of his employees testified that no payment for same was made to them. Of course declarations made, to be relevant as evidence, must have been voluntary and spontaneous and free from deliberate or studied design. *Mitchum v. State of Georgia, supra*; *Gibson Oil Co. et al. v. Westbrooke,* 160 Okl. 26, 16 P.2d 127; *McMahon v. Ed. G. Budd Mfg. Co. et al.,* 108 Pa. Super. 235, 164 A. 850.

The modern tendency is to extend, rather than to narrow, the rule as to the admission of declarations as part of the res gestae, especially in view of the fact that the parties now are generally permitted to testify in their own behalf and to consider the grounds which formerly excluded

such declarations as affecting their weight only. 'Its development has been promoted in modern times, by an effort to afford the triers of fact all reasonable means of ascertaining the truth, instead of withholding from them all information possible by the rigid application of certain rules of exclusion. The question is not how little, but how much, logically competent proof is admissible.' 10 R.C.L. 975, Sec. 158."

In *Barshop v. United States,* (5 Cir.) 191 Fed. 2d 286, 292, the Court states:

"The letter could be admissible only upon the theory that it is a part of the res gestae of the remittance. 'Res gestae must spring from the main fact; it presupposes a main fact and it means the circumstances, facts and declarations which grow out of the main fact, are contemporaneous with it, and serve to illustrate its character. * * *' *Yarbrough v. Prudential Ins. Co. of America,* 5 Cir., 99 F.2d 874, 876.

The main fact 'may, however, be either the ultimate fact to be proved or some fact evidentiary of that fact.' 32 C.J.S., Evidence, Sec. 405."

We submit that the dealings between Wolcher and Gersh fall within the rules of the foregoing cases. Besides, as stated in the cases of *Haigler v. United States*, 172 F. 2d 986 and *Cooper v. United States,* 9 F. 2d 216, quoted from on p. 60 of our opening brief, the defendant was entitled to show anything that had a tendency to demonstrate his honesty in dealing with the Government, including conversations had

with third persons that tended to support his testimony.

Dated, San Francisco, California,
June 11, 1954.

Respectfully submitted,
LEO R. FRIEDMAN,
Attorney for Appellant.

No. 14,109

IN THE

United States Court of Appeals

For the Ninth Circuit

LOUIS E. WOLCHER,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

APPELLANT'S PETITION FOR A REHEARING

(Or, If a Rehearing Be Denied, for a Stay of Mandate).

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To the Honorable William Healy, William Orr and Walter L. Pope, Judges of the United States Court of Appeals for the Ninth Circuit:

Appellant hereby respectfully petitions for a rehearing of the above cause, decided on December 28, 1954, on the ground that the opinion of this Court is in direct conflict with decisions of the Supreme Court, prior decisions of the above entitled Court, and decisions from other circuits. Also, that the reasoning used is not in conformity to the law and the facts.

THE OPINION UPHOLDING THE COMPLAINED OF INSTRUCTION IS IN DIRECT CONFLICT WITH PRIOR DECISIONS OF THE SUPREME COURT, THIS COURT AND OTHER CIRCUIT COURTS OF APPEAL.

This Court's opinion, upholding the giving of the instruction which told the jury to find the defendant guilty or not guilty, depending on whether credence should be given to defendant's testimony and story, is erroneous and contrary to all prior decisions for each of the following reasons:

1. The opinon holds no error in the complained of instruction because the general instructions fully covered the situation and that

> "* * * in the light of the accompanying instructions the jury could not rationally have understood the particular passage as shifting the burden of proof to the defendant, or as authorizing them to disregard frailties in the government's proof." (p. 3-4)

The instructions referred to in the opinion told the jury (i) The presumption is that the defendant is innocent, etc.; that the Government has the burden of proof; (ii) that the burden of proof never shifts to the defendant; (iii) that the defendant has no obligation to go forward and prove his innocence; (iv) the charge as contained in the indictment; (v) that the Government has the burden of proving the elements of the charge; (vi) the distinctions between net income and taxable income; (vii) that the Government need only prove a substantial amount of net income wilfully evaded by defendant; and (viii) the contentions of the Government and the defense.

Immediately following the foregoing the Court then gave the complained of instruction, to-wit:

> "So that in my opinion brings the issue of the case down to a very simple (question), and that is this—that since the Government has proved and the defendant has admitted receiving the cash over ceiling prices, the issue is whether you do or do not believe the testimony and the story told by the defendant in the case. If you believe his story, then you should return a verdict of not guilty. If you are convinced beyond a reasonable doubt that his story should not be believed, then you are justified in returning a verdict of guilty."

In other and simple words, the judge told the jury that in his opinion all they had to determine was whether the defendant's testimony was to be believed, if not they should find the defendant guilty. This instruction was most prejudicial and, undoubtedly, was accepted and acted upon by the jury.

A comparable situation is presented in the case of *Bollenbach v. United States,* 326 U.S. 607, 612, where our Supreme Court in no uncertain terms condemns such procedure:

> " 'The influence of the trial judge on the jury is necessarily and properly of great weight.' Starr v. United States, 153 US 614, 626, 38 L ed 841, 845, 14 S Ct 919, and jurors are ever watchful of the words that fall from him. Particularly in a criminal trial, the judge's last word is apt to be the decisive word. If it is a specific ruling on a vital issue and misleading, the error is not

> cured by a prior unexceptional and unilluminating abstract charge."

So here, despite the prior portions of the charge, when the judge told the jury that *in his opinion there was only one issue in the case*—the truth or falsity of defendant's story and testimony—the jury beyond a doubt must have accepted this as the standard by which they arrived at the verdict of guilty and appended thereto a recommendation of leniency.

In practically every case where a similar instruction has been given, the Courts have held it to be reversible error, although other portions of the charge correctly set forth the law as to burden of proof, presumption of innocence, etc.

This Court has assumed that the jury did not construe the instruction as telling them to find a verdict on the truth or falsity of defendant's testimony and in disregard of other evidence in the case; yet, this is exactly what the instruction stated. In the *Bollenbach* case, supra, p. 614, it is stated:

> "It would indeed be a long jump at guessing to be confident that the jury did not rely on the erroneous 'presumption' given them as a guide. A charge should not be misleading."

Here, it is "a long jump at guessing" to hold that the jury did not exactly follow the Court's erroneous charge and determine the issue solely on the truth or falsity of defendant's testimony. This is exactly what the instruction told the jury to do and, as stated in *Estep v. United States,* 327 U.S. 114, 136:

> "These words can only mean what they appear to mean if they are read as ordinary words should be read. Ordinary words should be read with their common, everyday meaning when they serve as directions for ordinary people."

In *Bihn v. United States,* 328 U.S. 633, the defendant was charged with conspiracy involving the stealing of ration coupons; she testified in her own behalf. The trial judge gave all the standard instructions on presumption of innocence, burden of proof, etc. (p. 637); then the Court told the jurors they had a right to consider whether she stole the coupons or someone else did, whether she stole them and who did if she didn't, that the jurors were to decide that. The Supreme Court reversed, holding that the correct instructions did not cure the erroneous charge which *could have been construed by the jury* as meaning that if they did not believe the defendant's testimony they must find that she did the stealing.

In *Balman v. United States* (8 Cir.), 94 F. 2d 197, the Court held that the charge in its entirety was full and correct (p. 199) but reversed the cause because the Court instructed the jury that it was their function to determine whether the defendant's explanation was true or untrue.

In *Olender v. United States,* 210 F.2d 795, this Court held a comparable instruction to be erroneous although the Court had given full and generous instructions on burden of proof, presumption of innocence, reasonable doubt, etc.

In *Ward v. United States* (5 Cir.), 96 F. 2d 189, correct general instructions were given but the cause was reversed because a portion thereof was susceptible of the interpretation of requiring the defendant to convince the jury that he was not guilty instead of requiring the United States to convince them that he was guilty.

And to like effect are the cases cited and quoted from on pages 4 to 8 of Appellant's Closing Brief filed herein.

It follows that the opinion of the Court herein is in conflict with prior decisions in holding that the general charge was sufficient to prevent the jury from construing the complained of instruction contrary to its express wording, to-wit, that the issue was whether the jury believed or disbelieved the defendant's story.

2. The opinion of this Court states that:

> "the jury could not rationally have understood the particular passage as shifting the burden of proof to the defendant, or as authorizing them to disregard frailties in the government's proof." (p. 3)
>
> "The instruction could hardly be understood by the jury as telling them to disregard these, or other circumstances in evidence, which might tend to corroborate appellant's account of his transactions or the asserted necessity of his paying overceiling prices." (p. 5)

By the foregoing, this Court has substituted the trained judicial minds of its judges for the untrained lay minds of the jurors in construing and applying

the trial Court's instructions. This cannot be done. The only matter to be considered is the effect the instruction had on the jury and the way the jurors *may have construed it.*

In *Olender v. United States,* 210 F. 2d 795, this Court, in construing an instruction comparable to but less damaging than the instruction given herein, stated:

> "While the words of the instruction did not in terms shift the burden of proof to the defendant, *they might well have had that effect in the minds of the jurors.*" (Italics ours.)

In *Bihn v. United States,* 328 U.S. 633, 637, our Supreme Court asserts:

> "We assume the charge might not be misleading or confusing to lawyers. But the probabilities of confusion to a jury are so likely (cf. Shepard v. United States, 290 US 96, 104, 78 L ed 196, 201, 54 S Ct 22) that we conclude that the charge was prejudicially erroneous."

And later in the *Bihn* case the Supreme Court states:

> "Or to put the matter another way, *the instruction may be read as telling the jurors* that, if petitioner by her testimony had not convinced them that someone else had stolen the ration coupons, she must have done so." (Italics ours.)

So here, the opinion is in error in not construing the instruction as it may have been construed by the jurors and in not giving to the words of the instruction their common every day meaning, to-wit, that

in the Judge's opinion the only issue to be determined was the truth or falsity of defendant's testimony.

At the very least the instruction was equivocal. Assuming that it could be construed in the manner this Court has determined, nevertheless, it is also susceptible of meaning that the jury should determine guilt or innocence on whether they believed or disbelieved appellant's testimony. In *Bollenbach v. United States, supra*, it is held

> "A conviction ought not to rest on an equivocal direction to the jury on a basic issue."

and in *Etting v. Bank of the United States,* 11 Wheat. 59, 75, 6 L ed 419, 422, the Court states:

> "But, if the judge proceeds to state the law, and states it erroneously, his opinion ought to be revised; and if it can have had any influence on the jury, their verdict ought to be set aside."

While in *Beaver v. Taylor,* 1 Wall. 637, 17 L ed 601, 603, the Supreme Court held that

> "If they (instructions) have misled the jury to the injury of the party against whom their verdict is given, the error is fatal."

Here, giving the instruction the plain meaning its words implied and conveyed to the jury, it must have had a great influence on the jury and worked irreparable injury to appellant and, under the foregoing cases, requires a reversal of the judgment.

3. The opinion holds that the instruction neither in substance nor effect told the jury to disregard all evidence other than the testimony of the defendant

himself (p. 5). The opinion then states "the problem confronting the jury was not whether whiskey was difficult to obtain or whether appellant was able to obtain it. Admittedly he did obtain the whiskey in question, albeit at what he said was a heavy over-ceiling price". While it is true defendant did obtain the whiskey in question, the problem confronting the jury was not whether he could or could not procure whiskey but whether he could procure whiskey without paying an over-ceiling price therefor when regular liquor dealers could not do so.

The opinion states that in view of the prima facie case presented by the Government "obviously in such condition of the record he had some explaining to do" (p. 4). Granting that when the Government made a prima facie case the burden of going forward and explaining that no taxable profit was made as a result of the whiskey transactions was on the defendant, but *this does not mean that he had to go forward with the testimony or that, in the absence of so proceeding, the jury were authorized to find him guilty.* A prima facie case merely means a case sufficient to be submitted to the jury, it then being the jury's duty to determine whether they believed the evidence introduced by the prosecution or whether it was sufficient to establish guilt beyond a reasonable doubt (*McCoy v. Courtney,* 25 Wash. 2d 956; 172 P. 2d 596).

In *Balman v. United States* (8 Cir.), 94 F. 2d 197, the Court instructed the jury that proof that defendant was in possession of recently stolen property raised a presumption of guilty knowledge in the ab-

sence of any explanation and it was for the jury to determine whether defendant's explanation as given at the trial was sufficient to overcome the presumption. The Appellate Court at page 199 held as follows:

> "As applied to the case under consideration, Judge Sanborn, in McAdams v. United States, supra, states the rule thus: 'The fact that the defendant had come into the possession of these cars shortly after they were stolen was a circumstance to be considered by the jury in connection with all of the other circumstances of the case in determining the question of his guilt or innocence. It was to be given its natural probative value and nothing more. It created at no time any presumption of law that the defendant knew that the cars were stolen, and, although it might have justified the inference, *it compelled no finding to that effect, even though he failed to give a satisfactory explanation.*' " (Italics ours.)

Lastly, this Court held "if the jury were convinced beyond a reasonable doubt that there was no truth in *appellant's defense,* then, certainly as the Court advised them, they were justified in returning a verdict of guilty" (p. 5).

For all the reasons hereinabove stated, this holding of the Court is erroneous. The complained of instruction did not refer to "appellant's defense". It referred to appellant's story and testimony. Furthermore, the jury could have entirely discredited appellant's testimony and still not have believed the prosecution's witnesses or have found that the prosecu-

tion's case failed to establish the charge beyond a reasonable doubt.

The instruction did not tell the jury that if they found no truth in appellant's defense they should convict; it told the jury that if they did not believe appellant's testimony they should convict, thus limiting the deliberations of the jury to appellant's testimony.

THE OPINION IS IN ERROR IN HOLDING THE TRIAL JUDGE WAS CORRECT IN REFUSING TO REOPEN THE CASE.

This Court holds that no error was committed in refusing to reopen the case in order that appellant could call Gersh as a witness. This Court's reasoning is that appellant was familiar with Gersh's testimony given at the former trial; that he knew where Gersh lived and he had had an opportunity to subpoena Gersh. This does not correctly portray the situation.

While it is true that appellant could have subpoenaed Gersh prior to the trial, the question facing the trial Judge and the appellant was not whether Gersh should have been called as a witness but it was the attempt of appellant to establish the bank records of Gersh. This appellant attempted to do by calling the government agent who had been in charge of the investigation from its inception and this agent denied acquiring any knowledge of the bank accounts until the conclusion of the first trial, even though such bank accounts had been offered in evidence by the prosecution at the first trial.

The important point is the refusal of the Court to allow appellant to establish these bank accounts and thus offer them into evidence. The attempt to get a continuance in order to call Gersh was just one step in this endeavor. No one disputes the importance of Gersh's bank accounts to the defense and it was the duty of the trial Court in the interests of justice, when all other attempts of the defense to establish these bank accounts had failed, to grant a reasonable continuance in order to produce the owner of these accounts to identify the records. As was said by our Supreme Court in its recent decision in *Holland v. United States,* decided December 6, 1954, 99 L ed (advance) 127, 137:

> "It is a procedure entirely consistent with the position long espoused by the Government, that its duty is not to convict but to see that justice is done."

It is submitted that the opinion of this Court is erroneous and in conflict with other pertinent decisions on the subjects involved. Appellant was denied a fair trial at the second trial of his case just as he was denied a fair trial at the first trial of his case. The multiplication of trials cannot take the place of a trial conducted in accordance with the standards provided by law and under proper judicial guidance of the jury. A rehearing should be granted.

In the event of a denial of this petition appellant intends to apply to the Supreme Court of the United States for a writ of certiorari and therefore prays for

a stay of a mandate of this Court for thirty days in order to enable appellant to make such application.

Dated, San Francisco, California,
January 21, 1955.

Respectfully submitted,
LEO R. FRIEDMAN,
Attorney for Appellant and Petitioner.

Certificate of Counsel.

I hereby certify that I am counsel for appellant and petitioner in the above entitled cause and that in my judgment the foregoing petition for a rehearing is well founded in point of law as well as in fact and that said petition for a rehearing is not interposed for delay.

Dated, San Francisco, California,
January 21, 1955.

Leo R. Friedman,
Counsel for Appellant and Petitioner.

No. 14,146

IN THE

United States Court of Appeals

For the Ninth Circuit

JEW SING,
Appellant,

vs.

BRUCE G. BARBER, District Director, Immigration and Naturalization Service, San Francisco District,
Appellee.

BRIEF FOR APPELLANT.

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BRIEF FOR APPELLANT.

JURISDICTION STATEMENT.

On November 24, 1953, there was filed in the United States District Court for the Northern District of California, Southern Division, in behalf of Jew Sing, hereinafter referred to as appellant, a petition for a writ of habeas corpus (T. 3). An oral application by counsel for an order to show cause was denied. The petition for writ of habeas corpus was likewise denied because it failed to state facts sufficient to warrant the writ (T. 10). This appeal followed (T. 11).

Jurisdiction of the District Court to entertain the petition for habeas corpus is conferred by 28 USC.

2241 et seq. Jurisdiction of the Court of Appeals to review the District Court's final order denying the writ of habeas corpus is conferred by 28 USCA 2253.

STATUTE INVOLVED.

Title 8 USCA 1253.

"Withholding of deportation.

(h) The Attorney General is authorized to withhold deportation of any alien within the United States to any country in which in his opinion the alien would be subject to physical persecution and for such period of time as he deems to be necessary for such reason. June 27, 1952, c. 477, Title II, ch. 5, § 243, 66 Stat. 212."

STATEMENT OF THE CASE.

Appellant is a native and citizen of China who first entered the United States in the early part of 1921, and resided continuously in the United States since that date except for a short visit to China of approximately five months duration in 1947. Upon appellant's return from China in 1947, he was ordered excluded and ordered deported to China. Following the deportation order the appellant was admitted into the United States by the Immigration and Naturalization Service on parole under bond. In September 1953, the appellant by and through his counsel submitted to the appropriate office of the Immigration and Naturaliza-

tion Service a verified petition praying for a stay of deportation under the provisions of 8 USCA 1253(h) on the ground that the appellant would suffer physical persecution and probable death if deported to Communist China.

In a letter dated November 3, 1953, the appellant was advised by the Immigration and Naturalization Service that "section 243(h) of the Immigration and Nationality Act has no application" to this case. In another letter the same day the appellant was notified to surrender himself for deportation to China.

In accordance with the demands of the Immigration and Naturalization Service the appellant and his wife, Wong King Gee, 9 C.A. Cal., No. 14147, surrendered to the District Director of the Service at San Francisco, California. At the time the petition was filed in the case at bar, deportation of the appellant to Communist China was imminent.

It was further alleged that the restraint of the appellant was illegal in that he had been denied "due process of law"; that his deportation to Communist China was contrary to law and the expression of Congress not to deport a person to a country where such person would suffer physical persecution; and that the decision of the Immigration and Naturalization Service denying his petition for a stay of deportation was an abuse of discretion.

SUMMARY OF ISSUES AND LEGAL ARGUMENT.

The refusal of the Immigration and Naturalization Service to give any consideration to the petition filed by appellant seeking a stay of deportation on physical persecution grounds was contrary to law; that the action of the Service was based upon an erroneous interpretation of the statute; and that the appellant is one entitled to the relief afforded by the provisions of Section 1253(h), Title 8.

ARGUMENT.

The Supreme Court of the United States, in a number of decisions over a long period of time, has consistently held that habeas corpus is available in a proper case as a remedy against unlawful deportation from the United States.

United States v. Sing Tuck, 194 U.S. 161, 48 L. Ed. 917, 24 S. Ct. 621;

Bilokumsky v. Tod, 263 U.S. 149, 68 L. Ed. 221, 44 S. Ct. 54;

Heikkila v. Barber, 345 U.S. 229, 97 L. Ed. 972, 978, 73 S. Ct. 972.

The immigration administrative decision is subject to judicial review where the proceedings have not conformed to the traditional standards of fairness required by the due process of law clause of the Fifth Amendment to the Constitution of the United States. *Japanese Immigrant Case,* 189 U.S. 86, 47 L. Ed. 721, 725, 23 S. Ct. 611; *Vajtauer v. Commissioner of*

Immigration, 273 U.S. 103, 71 L. Ed. 560, 563, 47 S. Ct. 302; *Wong Yang Sung v. McGrath,* 339 U.S. 33, 94 L. Ed. 616, 628, 70 S. Ct. 445; *Kwong Hai Chew v. Colding,* 344 U.S. 590, 97 L. Ed. 576, 584, 73 S. Ct. 472. Or where there has been arbitrariness or abuse of discretion by the administrative agency. *Low Wah Suey v. Backus,* 225 U.S. 460, 56 L. Ed. 1165, 1167, 32 S. Ct. 734; *Kwock Jan Fat,* 253 U.S. 454, 64 L. Ed. 1010, 1014, 40 S. Ct. 566; *Carlson v. Landon,* 342 U.S. 524, 96 L. Ed. 547, 558, 72 S. Ct. 525; *Yaris v. Esperdy,* 202 F. 2d 109, 112. The same general rule applies to determine whether or not the law has been correctly applied. *Gegiow v. Uhl,* 239 U.S. 3, 60 L. Ed. 114, 118, 36 S. Ct. 2; *Kessler v. Strecker,* 307 U.S. 22, 83 L. Ed. 1082, 1090, 59 S. Ct. 694; *Bridges v. Wixon,* 326 U.S. 135, 89 L. Ed. 2103, 2116, 65 S. Ct. 1443; *Fong Haw Tan v. Phelan,* 333 U.S. 6, 92 L. Ed. 433, 436, 68 S. Ct. 374. Cf. *McGrath v. Kristensen,* 340 U.S. 162, 95 L. Ed. 173, 181, 71 S. Ct. 224.

We have amply defined by the cases cited the power of the Courts to protect the rights of individuals in conformity with the fundamental principles of justice as embraced within the concepts of the Constitution of this nation. Quaere, applying those standards to the case at bar does the appellant's petition state a cause of action?

The petition was the only pleading filed in this cause. Thus, it becomes material to examine the allegations of the petition for the purpose of ascertaining whether a cause of action was stated of which a

Federal Court could take cognizance. For the purpose of this review the averments contained therein must be treated as true. *House v. Mayo,* 324 U.S. 42, 89 L. Ed. 739, 65 S. Ct. 517.

The appellant, an honorably discharged veteran of World War II, filed with the appropriate office of the Immigration Service a verified petition praying for a stay of deportation under the provisions of 8 CFR 243, 3(h), on the ground that he would be subject to physical persecution and probable death if deported to Communist China (T. 4 and 5). The Immigration and Naturalization Service, by and through their General Counsel, held that this appellant is not a person entitled to file an application for relief under the provisions of that part (T. 9).

Even though the letter of the General Counsel, Exhibit A of the pleadings, does not expressly set forth the basis for the rejection of the appellant's petition for a stay of deportation it must be presumed from his statements that the Department relies upon the statutory construction previously asserted in the cases of *Ng Lin Chong v. McGrath* and *Wong Lai King v. McGrath,* 202 F. 2d 316. In the *Ng* and *Wong* cases, the Immigration Service contended that Section 20 of the Immigration Act of February 5, 1917, as amended, was not applicable to an excluded alien who had been paroled and bonded into the United States. Instead, it was declared that these cases were governed by Section 18 of the same Act. The Court of Appeals for the District of Columbia ruled adversely to the government on both contentions.

The petition in the case at bar presents an actual controversy between the appellant and the immigration officials over the legal right of the appellant to apply for such stay of deportation. Accordingly, the beneficial provisions of that part were denied this appellant contrary to law.

We think the logical reasoning of the Court of Appeals for the District of Columbia in the *Ng* and *Wong* cases should be applied to the instant matter. We readily admit that such decision was predicated upon construction of Sections 18 and 20 of the Immigration Act of 1917, as amended. We also recognize the rule that issuance of a writ of habeas corpus must be determined by the statute in force at the time the petition is filed. *United States v. Shaughnessy,* 185 F. 2d 347, 349; *United States v. Shaughnessy,* 187 F. 2d 137, 142, aff'd sub nom., *Harisiades v. Shaughnessy,* 342 U.S. 580.

The pertinent provisions of Sections 18 and 20 were not substantially modified by Public Law 414, 82nd Congress, 2nd Session, 66 Stat. 163, the Immigration and Nationality Act of 1952. A comparison of the language of Sections 18 and 20 of the Act of 1917 to the pertinent provisions of Sections 237 and 243 are contained in the appendix attached hereto. (8 USCA 154, 156, 1227, 1253.)

The Board of Special Inquiry which heard appellant's case at the time of his arrival in 1947 has power, only, to "determine whether an alien who has been duly held shall be allowed to land or *shall be deported*"

(Sec. 17, Act of 1917; 8 USCA 153). "Deportation" includes "exclusion"—*Knauff v. McGrath,* 181 F. 2d 839. This Court has held that "deportation" is the removal, or *sending back,* of an alien to the country whence he came. *Yonijiro Makasuji v. Seager,* 73 F. 2d 37; 12 Words and Phrases Perm. Ed., page 136.

This appellant was ordered excluded by a Board of Special Inquiry convened pursuant to the provisions of Section 17, Immigration Act of 1917 (8 USCA 153); and that Board determined that the appellant should be deported. No hearing was ever held under the provisions of the Immigration and Nationality Act.

The provisions of Section 237 of the Immigration and Nationality Act (8 USCA 1227) are restricted to an alien "who is excluded under *this Act"* and who is "immediately deported to the country whence he came." Since the appellant was neither "excluded" under the provisions of that Act nor "immediately deported," it is obvious that that section is not applicable.

Section 243 of that Act (8 USCA 1253) specifically provides for the deportation of any alien whether his removal be under the provisions of that Act *"or any other Act."* It is under the provisions of this same section that the appellant filed his petition for a stay of deportation on physical persecution grounds. If it is established that his deportation must be effected under the provisions of this section, how can it be

logically concluded that he is not eligible even to file for the relief requested.

In *Ng Fung Ho v. White,* 259 U.S. 276, 285, 66 L. Ed. 938, Justice Brandeis said that deportation

> "May result also in *loss of both property and life;* or of all that makes life worth living." (Emphasis supplied.)

In *Wong Yang Sung v. McGrath,* supra, Justice Jackson, in a case involving a Chinese seaman who had deserted his vessel, said:

> "A deportation hearing involves issues basic to human liberty and happiness and, in the present upheavals in lands to which aliens may be returned, perhaps to *life itself.*" (Emphasis supplied.)

The drastic nature of the penalty of deportation has been noted in many other cases, and the strictness with which the law must be construed against the Government and in favor of the alien is observed from the Court's pronouncement in *Fong Haw Tan v. Phelan,* supra. That case involved a Chinese who had been convicted of two murders, committed simultaneously, and sentenced to life imprisonment for each offense; the Attorney General sought to deport him under Section 20 of the 1917 Act, as one who has been "sentenced more than once." In holding that, of two possible constructions of the deportation statute, the one favoring the alien must be adopted, the Court said:

> "We resolve the doubts in favor of that construction because deportation is a drastice measure and at times the equivalent of banishment or exile, Delgadillo v. Carmichael, 332 U.S. 388, ante, 17, 58 S. Ct. 10. It is the forfeiture for misconduct of a resident in this country. Such a forfeiture is a penalty. To construe this statutory provision less generously to the alien might find support in logic. But since the stakes are considerable for the individual, we will not assume that Congress meant to trench on his freedom beyond that which is required by the narrowest of several possible meanings of the words used."

Any contention that exclusion does not lead to deportation is as erroneous as it is unrealistic. At the time of filing the petition for a writ of habeas corpus deportation of this appellant to Communist China was imminent. We assert, with reasonable justification, that this appellant would suffer physical persecution and probable loss of life as a result of such arbitrary and capricious administrative action.

The Attorney General, through the Commissioner, Immigration and Naturalization Service, decided, when considering an application for adjustment of status under the Displaced Persons Act of 1948, that a Chinese temporarily in the United States as a student cannot be deported to Communist China because of "persecution or fear of persecution on account of race, religion or political opinions," Interim Decision No. 212, in the Matter of T. C., File No. A 6 730648, decided November 7, 1950, Immigration and Natural-

ization Service "Monthly Review," January 1951, Vol. VIII No. 7, pp. 95-98. In that case, summing up his findings relative to the communistic nature of the *de facto* government of China, the Commissioner said:

> "In summation, then, it will be concluded that the de facto Government of China is Communistic, and as Communistic as the Government of Russia and the countries behind the Iron Curtain."
>
> * * * * * * *
>
> "Fear to Return: The applicant's testimony above relative to displacement based upon his fear of persecution will be utilized to establish that other cardinal eligibility requisite, namely, that the applicant is unable to return to the country of his birth, nationality, or last residence, because of persecution or fear of persecution on account of his race, religion or political opinions. His testimony with respect to his opposition to Communism, and the acknowledgment that China is at this time a Communist-dominated country establishes that the applicant is unable to return to China because of his fear of persecution on account of his political opinions."

It is a matter of common knowledge that China has been wholly overrun by the armed forces of the Chinese Communists; that the recognized government of the Republic of China fled to Formosa; that the principles of the Chinese Communist Government are contradictory to the principles of free and democratic government; and that the Communists have engaged in a campaign of mass murder of Chinese for vaguely defined "crimes", and that the Communist press in

China, itself, puts the number of executions in excess of a million.[1] It is equally common knowledge that the Communists are ruling China by mass murder.[2]

In a release dated February 23, 1954, Washington, D.C., the House Appropriations Committee stated that Walter S. Robertson, Assistant Secretary of State for Far Eastern Affairs testified Red Chinese have slaughtered about 15,000,000 of their own people since 1949 which showed "just about the bloodiest pattern that the Communists have followed in any country in the world."

In view of these known conditions there can be no room for doubt that appellant, an honorably discharged member of the United States Army, would be the likely object of the Communist regime.

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[1] "Reds Digesting China," by Marguerite Higgins, Washington Post, October 1, 1951.

[2] "They're Ruling China by Mass Murder," Saturday Evening Post, October 13, 1951, p. 31; at page 167, the author points out that under the most intense suspicion, and consequent danger of extermination, are Chinese "individuals who once worked for or associated with Europeans, *particularly Americans,*" and that "in a majority of cases Chinese are arrested not because they commit some overt act against the state, but because they belong to classes or categories distrusted by the communists and suspected of harboring dangerous (unorthodox) thoughts. They are sources of *potential* opposition to the regime." (Emphasis supplied.)

The United Nations General Assembly was informed November 12, 1951, that there would be no lasting peace with Red China, in Korea, or elsewhere, so long as China is dominated by "the Communist rule of mass murder"—Washington Times-Herald, November 13, 1951, page 1. Dr. T. F. Tsiang, the Chinese representative before the U. N. General Assembly, stated official announcements by Chinese Communist authorities admitted that 1,176,000 so-called counter-revolutionaries had been liquidated from October 1, 1949 to October 1, 1950, in the provinces of China, including that from which appellant originally came.

The United Nations, through the persistent efforts of the United States, refused for a period of approximately two years to mediate the Korean situation unless all parties agreed that captured Chinese Communist soldiers would not be repatriated to Communist China against their wishes. During this period, this nation, alone, sustained 25,000 casualties. Let's hope that these members of our armed forces did not suffer in vain.

Return of any individual despite his objection to a Communist-dominated country would be flatly inconsistent with the principle adhered to in the Korean prisoner of war negotiations. Deportation of a former member of our own armed forces to Communist tyranny would stultify our national policy of protecting those who have fled communist oppression and make mockery of our national efforts to win over world opinion for the cause of freedom.

This Court in *Carmichael v. Delaney,* 170 F. 2d 239, at page 245, stated:

> "Throughout history banishment or exile has been looked upon as a penalty little less dreadful than death. To one in appellee's situation, exclusion is in substance and practical effect the equivalent of banishment. It involves the same severance from home and existing ties that the individual suffers who is expelled from the country in a proceeding to deport. There is no difference in their loss of freedom of movement or in the nature of the hardships they are called upon to undergo. *The sole*

> *distinction resides in the mere matter of nomenclature.* The distinction, we think, is of no moment so far as concerns the constitutional guaranty of due process of law." (Italics supplied.)

The statute in effect at the time of filing this petition required the Attorney General to consider and exercise his discretion consistent "with the fundamental principles of justice embraced within the conception of due process of law." *Tang Tung v. Edsell,* 223 U.S. 673, 56 L. Ed. 606, 610, 32 S. Ct. 569; *Joint Anti-Fascist Refugee Comm. v. McGrath,* 341 U.S. 123, 95 L. Ed. 817, 71 S. Ct. 624; *Carlson v. Landon,* 342 U.S. 524, 96 L. Ed. 547, 72 S. Ct. 525.

In *Stack v. Boyle,* 342 U.S. 1, 96 L. Ed. 317, Mr. Chief Justice Vinson warned that we should not "inject into our own system of government the very principles of totalitarianism which Congress was seeking to guard against in passing the statute." This warning is particularly appropriate in the setting of the instant case. The Attorney General, through his administrative officers, arbitrarily and without just cause, condemned the appellant to probable execution.

The Fifth Amendment to the Constitution of the United States provides that "no person shall * * * be deprived of life, liberty, or property, without due process of law." We assert that there was an invasion of that constitutional right by the Immigration and Naturalization Service.

It is within the province of the Courts to test the validity of oppressive administrative action in a habeas corpus proceeding. This action was brought for that specific purpose.

CONCLUSIONS.

To prevent abuse of the Attorney General's extraordinary powers over the lives and destinies of our foreign born, judicial intervention is appropriate herein. The fate of the appellant is at stake.

Congress as recently as August 7, 1953, when enacting the Refugee Act of 1953, recognized that it was impossible for people instilled with democratic philosophy to live in Communist dominated countries. It was the purpose and intent of Section 1253(h), Title 8, to prevent, for humanitarian reasons, deportation of worthy aliens who would suffer physical persecution.

The appellant was ordered excluded and deported and the contemplated action of the Immigration Service is deportation. Such deportation is included within the statutory language of the provisions of Section 1253(h). Failure of the Immigration and Naturalization Service to consider the appellant's verified petition filed pursuant to the provisions of that part was a denial of a vital right guaranteed by the Constitution and laws of our nation. The failure of the Court below to consider this problem was error.

The decision should be reversed with instructions that the writ of habeas corpus issue.

Dated, San Francisco, California,
February 26, 1954.

Respectfully submitted,
JACKSON & HERTOGS,
By JOSEPH S. HERTOGS,
Attorneys for Appellant.

(Appendix Follows.)

Appendices.

Appendix

Section 18—Act of February 5, 1917, 8 U.S.C.A. 154.

"Immediate deportation of aliens brought in in violation of law; cost of maintenance and return.

All aliens brought to this country in violation of law shall be immediately sent back, in accommodations of the same class in which they arrived, to the country whence they respectively came, on the vessels bringing them, unless in the opinion of the Attornel General immediate deportation is not practicable or proper. The cost of their maintenance while on land, as well as the expense of the return of such aliens, shall be borne by the owner or owners of the vessels on which they respectively came. It shall be unlawful for any master, purser, person in charge, agent, owner, or consignee of any such vessel to refuse to receive back on board thereof, or on board any other vessel owned or operated by the same interests, such aliens; or to fail to detain them thereon; or to refuse or fail to return them in the manner aforesaid to the foreign port from which they came; or to fail to pay the cost of their

Section 237, Immigration and Nationality Act, 8 U.S.C.A. 1227.

"Immediate deportation of aliens excluded from admission or entering in violation of law —Maintenance expenses.

(a) Any alien (other than an alien crewman) arriving in the United States who is excluded under this chapter, shall be immediately deported to the country whence he came, in accommodations of the same class in which he arrived, on the vessel or aircraft bringing him, unless the Attorney General, in an individual case, in his discretion, concludes that immediate deportation is not practicable or proper. The cost of the maintenance including detention expenses and expenses incident to detention of any such alien while he is being detained, as well as the transportation expense of his deportation from the United States, shall be borne by the owner or owners of the vessel or aircraft on which he arrived, except * * *

Unlawful practice of transportation lines.

(b) It shall be unlawful for any master, commanding offi-

maintenance while on land; or to make any charge for the return of any such alien, or to take any security for the payment of such charge; or to take any consideration to be returned in case the alien is landed; * * *"

cer, purser, person in charge, agent, owner, or consignee of any vessel or aircraft (1) to refuse to receive any alien (other than an alien crewman), ordered deported under this section back on board such vessel or aircraft or another vessel or aircraft owned or operated by the same interests; (2) to fail to detain any alien (other than an alien crewman) on board any such vessel or at the airport of arrival of the aircraft when required by this chapter or if so ordered by an immigration officer, or to fail or refuse to deliver him for medical or other inspection, or for further medical or other inspection, as and when so ordered by such officer; (3) to refuse or fail to remove him from the United States to the country whence he came; (4) to fail to pay the cost of his maintenance while being detained as required by this section or section 1223 of this title; (5) to take any fee, deposit, or consideration on a contingent basis to *ke*[1] kept or returned in case the alien is landed or excluded; * * *"

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[1]So in original. Probably should read "be".

Section 20, Act of February 5, 1917, 8 U.S.C.A. 156.

"Ports to which aliens to be deported, cost of deportation.

The deportation of aliens provided for in this chapter shall, at the option of the Attorney General, be to the country whence they came or to the foreign port at which such aliens embarked for the United States; or, if such embarkation was for foreign contiguous territory, to the foreign port at which they embarked for such territory; or, if such aliens entered foreign contiguous territory from the United States and later entered the United States, or, if such aliens are held by the country from which they entered the United States not to be subjects or citizens of such country, and such country refuses to permit their reentry, or imposes any condition upon permitting reentry, then to the country of which such aliens are subjects or citizens, or to the country in which they resided prior to entering the country from which they entered the United States. * * *"

Section 23 of the Internal Security Act of 1950 (Public Law 831, 81st Cong., 2d Sess.; 64 Stat.) 8 U.S.C.A. 156, amended Section 20 of the Immigration Act of February 5, 1917 so as to read, in pertinent part, as follows:

"Sec. 20(a) That the deportation of aliens provided for in this Act and all other immigration laws of the United States shall be directed by the Attorney General to the country specified by the alien, if it is willing to accept him into its territory; otherwise such deportation shall be directed by the Attorney General within his discretion and without priority of preference because of their order as herein set forth, either to the country from which such alien last entered the United States or to the country in which is located the foreign port at which such alien embarked for the United States or for foreign contiguous territory; or to any country in which he resided prior to entering the country from which he entered the United States or to the country which had sovereignty over the birthplace of the alien at the time of his birth; or to any country

Section 243 of the Immigration and Nationality Act, 8 U.S.C.A. (effective December 24, 1952).

"Countries to which aliens shall be deported—Acceptance by designated country; deportation upon nonacceptance by country.

(a) The deportation of an alien in the United States provided for in this chapter, or any other Act or treaty, shall be directed by the Attorney General to a country promptly designated by the alien if that country is willing to accept him into its territory, unless the Attorney General, in his discretion, concludes that deportation to such country would be prejudicial to the interests of the United States. * * * Thereupon deportation of such alien shall be directed to any country of which such alien is a subject[1] national, or citizen if such country is willing to accept him into its territory. If the government of such country fails finally to advise the Attorney General or the alien within three months following the date of original inquiry, or within such other period as the Attorney General shall deem reasonable under the circumstances in a particu-

[1]So in original. Probably should read with a ",".

try of which such an alien is a subject, national, or citizen; or to the country in which he was born; or to the country in which the place of his birth is situated at the time he is ordered deported; or, if deportation to any of the said foregoing places or countries is impracticable, inadvisable, or impossible, then to any country which is willing to accept such alien into its territory. * * * No alien shall be deported under any provisions of this Act to any country in which the Attorney General shall find that such alien would be subjected to physical persecution."

lar case, whether that government will or will not accept such alien into its territory, then such deportation shall be directed by the Attorney General within his discretion and without necessarily giving any priority or preference because of their order as herein set forth either— * * *.

Withholding of deportation.

(h) The Attorney General is authorized to withhold deportation of any alien within the United States to any country in which in his opinion the alien would be subject to physical persecution and for such period of time as he deems to be necessary for such reason."

No. 14,146

IN THE

United States Court of Appeals

For the Ninth Circuit

JEW SING,

Appellant,

vs.

BRUCE G. BARBER, District Director, Immigration and Naturalization Service, San Francisco District,

Appellee.

BRIEF FOR APPELLEE.

LLOYD H. BURKE,
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MILTON T. SIMMONS,
Acting District Counsel,
Immigration and Naturalization Service.
On the Brief.

BERNAE WELSH PRINTING CO., SAN FRANCISCO

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No. 14,146

IN THE

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Appellee.

BRIEF FOR APPELLEE.

STATEMENT OF THE CASE.

The appellant is a native and citizen of China who first entered the United States in 1921 and who departed from the United States for a visit to China in 1947. Upon his return to the United States on October 14, 1947, he applied for admission as a native-born United States citizen. He was accorded a hearing before a Board of Special Inquiry and was excluded from the United States on the ground that he was not a native-born citizen of the United States but was an alien immigrant not in possession of a valid immigration visa.

In September 1953 the appellant filed an application for a stay of deportation under the provisions of 8 C.F.R. 243.3(h) (8 U.S.C.A. 1253(h)), alleging that deportation to China would subject him to physical persecution. The appellant was advised by the Immigration and Naturalization Service that Section 243(h) did not apply to his case, and he was informed that if he failed to depart from the United States he would be ordered deported.

When appellant was taken into custody for deportation proceedings, he petitioned for a writ of habeas corpus. The petition was denied by United States District Judge Goodman because it did not state facts sufficient to warrant the writ. This is an appeal from the order of the District Court.

STATUTE INVOLVED.

Section 243(h), Immigration and Nationality Act (8 U.S.C.A. 1253(h)):

> "The Attorney General is authorized to withhold deportation of any alien within the United States to any country in which in his opinion the alien would be subject to physical persecution and for such period of time as he deems to be necessary for such reason."

ARGUMENT.

The appellant does not challenge the validity of the deportation order. He is concerned only with the application for *stay of deportation* and states that the issues involved in this appeal are:

1. The refusal of the Immigration and Naturalization Service to give any consideration to the petition filed by the appellant seeking a stay of deportation on physical persecution grounds was contrary to law.

2. The action of the Service was based on an erroneous interpretation of the statute.

3. The appellant is entitled to the relief afforded by the provisions of 8 U.S.C.A. 1253(h).

The appellee declined to consider an application for a stay of deportation under Section 1253(h) for the sole reason that the appellant was an *excluded* alien. It is the view of the Immigration and Naturalization Service that 8 U.S.C.A. 1253(h) applies only to aliens within the United States against whom *expulsion* deportation proceedings are instituted. Thus, the sole issue in this appeal is whether the appellant, an *excluded* alien, is entitled to have his application for a stay of deportation under the provisions of Section 1253(h) entertained by the Immigration and Naturalization Service.

We agree with appellant that habeas corpus is the proper method of judicial review of deportation orders, either exclusion or expulsion, but appellant herein does not seek review of the deportation order.

Appellant contends that deportation includes exclusion. It is true that the word "deportation" is applied to both exclusion and expulsion proceedings. However, there is a time-honored distinction between expulsion by arrest and deportation and exclusion deportation. The provisions of Section 18 of the Immigration Act of 1917 (8 U.S.C.A. 154) as related to exclusion were, with some modification, restated in Section 237 of the Immigration and Nationality Act (8 U.S.C.A. 1227). The provisions of the same Act as related to arrest and deportation of aliens (expulsion), Section 20 of the Immigration Act of 1917 (8 U.S.C.A. 156), were restated with some changes in Section 243 of the Immigration and Nationality Act (8 U.S.C.A. 1253). It is submitted that under the Immigration and Nationality Act, as in prior legislation, there have been two distinct classes of deportation proceedings: One relating to the alien whose application for admission to the United States is denied. Such alien is excluded and deported. The second relating to the alien *in* the United States who is arrested and deported after *expulsion* proceedings.

The provisions for stay of deportation on the grounds of physical persecution are included in Section 243. This section is concerned only with arrest and deportation (expulsion) of aliens. The beginning of the first sentence of Section 243, "The deportation of an alien *in the United States* * * *' clearly identifies the alien to whom it is applicable.

It is well established that an alien excluded from admission is not *in* the United States, but is in the status of having been stopped at the border.

Shaughnessy v. Mezei, 345 U.S. 206;
Ekiu v. United States, 142 U.S. 651;
United States v. Ju Toy, 198 U.S. 253;
Kaplan v. Tod, 267 U.S. 228;
Suey v. Spar, 149 F. 2d 881;
Pantano v. Corsi, 65 F. 2d 322;
Stoma v. Commissioner of Immigration at New Orleans, 18 F. 2d 576.

Appellant contends that he is being deported under the provisions of 8 U.S.C.A. 1253 in that Section 237 (8 U.S.C.A. 1227) cannot apply to his case because it applies only to exclusions under *"this Act"* (Immigration and Nationality Act of 1952) and not the Immigration Act of 1917, under which appellant was excluded. Appellant asserts that Section 243 is applicable because it provides for deportation of aliens under this Act *or any other Act.* Section 243 applies to aliens *in the United States* who are arrested and deported (expulsed) under the Immigration and Nationality Act of 1952 or any prior Act, but has no relation to the exclusion of aliens and consequent deportation under the immigration laws. This appellant was excluded under the provisions of the Act of 1917.

Section 405(a) of the Immigration and Nationality Act (footnote to 8 U.S.C. 1101) provides:

"Nothing contained in this Act, unless otherwise specifically provided therein, shall be construed to affect the validity of any declaration of intention, petition for naturalization, certificate of naturalization, certificate of citizenship, warrant of arrest, order or warrant of deportation, *order of exclusion,* or other document or proceeding which shall be valid at the time this Act shall take effect * * *." (Emphasis ours.)

The exclusion order under the 1917 Act is still valid by virtue of the provisions of Section 405(a), and the appellee proposes to deport the appellant under its authority. It is submitted that the appellant is not an alien "in the United States" within the meaning of Section 243 of the Immigration and Nationality Act. He is therefore not entitled to make application for a stay of deportation under the provisions of Section 243(h) (8 U.S.C.A. 1253(h)). The decision of the court below should be affirmed.

Dated, San Francisco, California,
May 26, 1954.

LLOYD H. BURKE,
United States Attorney,
CHARLES ELMER COLLETT,
Assistant United States Attorney,
Attorneys for Appellee.

MILTON T. SIMMONS,
Acting District Counsel,
Immigration and Naturalization Service,
On the Brief.

No. 14157

United States Court of Appeals

for the Ninth Circuit

VICTOR F. GOTHBERG, an Individual, Doing Business as Gothberg Construction Company,
Appellant,

vs.

IRENE ARNOLD,
Appellee;

SULLENS & HOSS, INC., a Corporation,
Appellant,

vs.

IRENE ARNOLD,
Appellee;

UNITED STATES OF AMERICA,
Appellant,

vs.

IRENE ARNOLD,
Appellee.

Transcript of Record

Appeals from the District Court for the Territory of Alaska Third Division

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—8-20-54

No. 14157

United States
Court of Appeals
for the Ninth Circuit

VICTOR F. GOTHBERG, an Individual, Doing Business as Gothberg Construction Company,
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IRENE ARNOLD,
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SULLENS & HOSS, INC., a Corporation,
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UNITED STATES OF AMERICA,
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Appeals from the District Court
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the District Court for the Territory of Alaska,
Third Division

No. A-7261

IRENE ARNOLD,

Plaintiff,

vs.

ALICE ROBERTS KELSEY and R. W. KELSEY,
Husband and Wife, et al.,

Defendants.

STATEMENT OF FACTS

The following statement of facts was compiled from the records of the Clerk of the District Court for the Territory of Alaska, Third Division, and the office of the U. S. Commissioner, Anchorage Recording Precinct, Territory of Alaska, and reflects all liens and encumbrances of record against the following-described real property:

> Lots Eight (8) and Nine (9) in Tract A of the Hillstrand Subdivision of the North Half of the Northwest Quarter of the Southeast Quarter of the Southeast Quarter of Section 24, Township 13 North, Range 4 West, Seaward Meridian, Alaska, according to the map and plat thereof on file with the United States Commissioner's Office, at Anchorage, Alaska.

A. Alice Roberts Kelsey and R. W. Kelsey

I.

That at the times mentioned in plaintiff's complaint, the defendant, Alice Roberts Kelsey, was the

record owner, and R. W. Kelsey was the reputed owner of the above-described real property.

II.

That on the 25th day of January, 1952, the said R. W. Kelsey and Alice Roberts Kelsey were duly adjudged bankrupts by the above-entitled Court.

III.

That on the 1st day of May, 1952, Irene Arnold was appointed Trustee of said brankrupts' estate, and she ever since has been, and now is such Trustee.

B. Irene Arnold

I.

That on or about the 17th day of September, 1949, in the City of Anchorage, Third Division, Territory of Alaska, the defendant, Alice Roberts Kelsey, made, executed and delivered to the plaintiff her real mortgage, dated September 17, 1949, to secure the payment of the sum of Five Thousand Dollars ($5,000.00), loaned by said plaintiff to said defendant, together with interest at the rate of eight per cent (8%) per annum, payable on or before December 17, 1950, which was given up on the above-described property; that said mortgage was recorded in the office of the U. S. Commissioner, Anchorage Precinct, Alaska, on the 20th day of September, 1949, in Book 84 at page 66, of the City Records.

II.

That on or about the 22nd day of December, 1950, at Anchorage, Alaska, the defendants, Alice Roberts

Kelsey and R. W. Kelsey, in order to give security for additional loans advanced by the plaintiff to the said defendants, and in order to consolidate these amounts with the sum of Five Thousand Dollars ($5,000.00), previously secured by said mortgage dated the 17th day of September, 1949, made, executed and delivered to the plaintiff their certain promissory note in writing, bearing date on that day, in the sum of $16,609.51.

III.

That in order to secure the payment of the said promissory note, and the interest thereon, the defendants on the 22nd day of December, 1950, made, executed and delivered to the plaintiff their Real Estate Mortgage bearing date of that day to secure the payment of the sum of Sixteen Thousand Six Hundred Nine and 51/100 Dollars ($16,609.51), loaned by said plaintiff to the said defendants, together with interest at the rate of eight per cent (8%) per annum, payable at the rate of $350.00 per month, plus interest, until paid in full; that said mortgage was recorded in the office of the U. S. Commissioner, Anchorage Precinct, Alaska, in Book 107 at Page 187, on the 16th day of January, 1951.

IV.

That no part of the principal and interest mentioned in said note and mortgage has been paid, save and except the sum of One Thousand Nine Hundred Fifty-five and 13/100 Dollars ($1,955.13); that there is still due and owing from the said defendants to

the plaintiff the sum of Fifteen Thousand Three Hundred Forty-four and 81/100 Dollars ($15,344.-81), together with interest thereon at the rate of eight per cent (8%) per annum from the 3rd day of July, 1951, as evidenced by Civil Case No. A-7261.

C. Heinie Berger

I.

On December 14, 1950, R. W. Kelsey and Alice Roberts Kelsey, defendants, executed and delivered to Heinie Berger a written promissory note in the amount of $1,959.22, which sum bore interest at the rate of eight per cent (8%) per annum from date.

II.

That in order to secure the payment of the said promissory note, and the interest thereon, the defendants on the 14th day of December, 1950, made, executed and delivered to the said Heinie Berger their Real Estate Mortgage upon the above-described real property; that said mortgage was recorded in the office of the U. S. Commissioner, Anchorage Precinct, Alaska, in Book 53 at Page 291, on the 19th day of December, 1950.

III.

That no part of the debt evidenced by said note and mortagage has been paid; that said promissory note and mortgage are now in default.

D. Ketchikan Spruce Mills

I.

Ketchikan Spruce Mills is a corporation organized

and existing under the laws of the Territory of Alaska.

II.

That Ketchikan Spruce Mills, at the instance and request of Alice Roberts Kelsey and Royal W. Kelsey, furnished material which was used upon the above-described property; that the reasonable value of said material is $250.00, and the last of it was furnished November 26, 1949.

III.

That on the 21st day of February, 1950, and within ninety (90) days after the last day materials were furnished, Ketchikan Spruce Mills duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was duly recorded in Book 88 at Page 140, of Precinct records.

IV.

That on April 26, 1950, said Ketchikan Spruce Mills filed an action in the above-entitled Court to foreclose said lein, being cause No. 6132; that the complaint in said action prayed for recovery of the sum of $250.00 plus interest at the rate of six per cent (6%) per annum from November 26, 1949; $18.75 for preparing and filing said lien; costs and disbursements and a reasonable attorney's fee.

V.

No part of said lien or of the monies prayed for in said Civil Action No. A-6132 has been paid, and

all of the same is now due and owing to the said Ketchikan Spruce Mills.

E. Kincaid & King Construction Co., Inc.

I.

Kincaid & King Construction Co., Inc., is a corporation organized and existing under the laws of the Territory of Alaska.

II.

That Kincaid & King Construction Co., Inc., at the instance and request of Alice Roberts Kelsey and Royal W. Kelsey, furnished materials which were used in the construction of the building upon the above-described real property: that the reasonable value of said materials is $474.00, and the same was furnished between August 24, 1950, and October 28, 1950.

III.

That no part of said sum has been paid, save and except the sum of $50.00, and a credit of $15.75 was allowed the said defendants on materials returned, leaving a balance due and owing of $408.25.

IV.

That on the 26th day of January, 1951, and within ninety (90) days after the last day upon which materials were furnished, Kincaid & King Construction Co., Inc., duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was duly recorded in Book 108 at Page 22 of City Records.

V.

That on July 24, 1951, said Kincaid & King Construction Co., Inc., filed an action in the above-entitled Court to foreclose said lien, being cause No. A-7063; that the complaint in said action prayed for recovery of the sum of $408.25 plus interest at the rate of six per cent (6%) per annum from October 28, 1950; $20.00 for preparation and recording of statement of lien; costs and disbursements and a reasonable attorney's fee.

VI.

No part of said lien or of the monies prayed for in said Civil Action No. A-7063 has been paid, and all of the same is now due and owing to the said Kincaid & King Construction Co., Inc.

F. D. H. Cuddy, Trustee

I.

On August 13, 1951, R. W. Kelsey and Alice Roberts Kelsey, defendants, executed and delivered to D. H. Cuddy, Trustee for Pat Ryan, Erma Schuler, V. W. Garrison and The Alaska Plumbing & Heating Co., Inc., a written promissory note in the amount of $4,131.00, which sum bore interest at the rate of eight per cent (8%) per annum from date.

II.

That in order to secure the payment of the said promissory note, and the interest thereon, the defendants on the 13th day of August, 1951, made, executed and delivered to the said D. H. Cuddy,

Trustee, their Real Estate Mortgage upon the above-described real property; that said mortgage was recorded in the office of the U. S. Commissioner, Anchorage Precinct, Alaska, in Book 117 at Page 197, of City Records, on the 16th day of August, 1951.

III.

That no part of the debt evidenced by said note and mortgage has been paid; that said promissory note and mortgage are now in default.

G. Kenneth W. Luse

I.

That Kenneth W. Luse, an individual, doing business as Ken Luse & Company, at the instance and request of Royal W. Kelsey, and with the full knowledge of Alice Roberts Kelsey, furnished labor, materials and supplies for painting and decorating apartments located upon the above-described property; that the reasonable value of said services and materials is $2,375.05, and the same were furnished between May 19, 1951, and July 28, 1951.

II.

That on the 14th day of August, 1951, and within ninety (90) days after the last day upon which said services and materials were furnished, Kenneth W. Luse duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was duly recorded in Book 117 at Page 162, of City Records.

III.

That on December . ., 1951, said Kenneth W. Luse filed a Cross-Complaint in the above-entitled action to foreclose said lien; that the Cross-Complaint prayed for recovery of the sum of $2,375.05, plus interest thereon at the rate of six per cent (6%) per annum from July 28, 1951; $21.00 for preparing and filing said lien; costs and disbursements and a reasonable attorney's fee.

IV.

No part of said lien or of the monies prayed for in said Civil Action No. A-7261 has been paid, and all of the same is now due and owing to the said Kenneth W. Luse.

H. William Stolt and Lilian Stolt

I.

That William Stolt and Lilian Stolt, doing business as Bill's Electric Supply and Service Shop, at the instance and request of Royal W. Kelsey, and with full knowledge of Alice Roberts Kelsey, furnished labor, materials and supplies in electrical installations in the apartments and improvements upon the above-described property; that the reasonable value of said services and materials is $140.18, and the same were furnished between July 17, 1951, and July 19, 1951.

II.

That on the 12th day of October, 1951, and within ninety (90) days after the last day upon which said services and materials were furnished, William

Stolt and Lilian Stolt duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was duly recorded in Book 120 at Page 339, of City Records.

III.

That on January .., 1952, said William Stolt and Lilian Stolt filed a Cross-Complaint in the above-entitled action to foreclose said lien; that the Cross-Complaint prayed for recovery of the sum of $140.18 plus interest at the rate of six per cent (6%) per annum from July 19, 1951; $21.50 for the preparation and recording of the statement of lien; costs and disbursements and a reasonable attorney's fee.

IV.

That no part of said lien or of the monies prayed for in said Civil Action No. A-7261 has been paid, and all of the same is now due and owing to the said William Stolt and Lilian Stolt.

I. Henry F. Wollf, Inc.

I.

Henry F. Wollf, Inc., is a corporation organized and existing under the laws of the Territory of Alaska.

II.

That Henry F. Wollf, Inc., at the instance and request of Royal W. Kelsey, and with full knowledge of Alice Roberts Kelsey, furnished materials in the construction, improvement or repair of cer-

tain apartments upon the above-described property; that the reasonable value of said materials is $1,166.11, and the same were furnished between July 11, 1951, and July 28, 1951.

III.

That no part of said sum has been paid, but the account has been credited with the sum of $600.00 for equipment purchased by Henry F. Wollf, Inc., from said defendants, leaving a balance due and owing of $566.11.

IV.

That on the 20th day of October, 1951, and within ninety (90) days after the last day upon which materials were furnished, Henry F. Wollf, Inc., duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was duly recorded in Book 121 at Page 71, of City Records.

V.

That on December .., 1951, said Henry F. Wollf, Inc., filed a Cross-Complaint in the above-entitled action to foreclose said lien; that the Cross-Complaint prayed for recovery of the sum of $566.11, plus interest thereon at the rate of six per cent (6%) per annum from July 28, 1951; $18.75 for preparing and filing said lien; costs and disbursements and a reasonable attorney's fee.

VI.

No part of said lien or of the monies prayed for in said Civil Action No. A-7261 has been paid, and

all of the same is now due and owing to the said Henry F. Wollf, Inc.

J. Henry W. Cuffel

I.

That on the 21st day of August, 1951, Henry W. Cuffel, an individual, doing business as Northern Neon Sign Company, filed an action in the above-entitled Court against the defendants, R. W. Kelsey and Alice Roberts Kelsey, to recover the sum of $1,240.00 due upon a conditional sales contract; that said action is Cause No. A-7131.

II.

That by virtue of a Writ of Attachment issued by the above-entitled Court in said action, the U. S. Marshal for the Third Division, Territory of Alaska, attached the above-described real property belonging to said defendants and caused a Certificate of Attachment of property to be filed in the U. S. Commissioner's office, Anchorage Recording Precinct, and recorded in Book 115 at Page 256, of City Records, on August 21, 1951.

III.

That no part of the monies prayed for in said Civil Action No. 7131 has been paid, and all of the same is now due and owing to the said Henry W. Cuffel.

K. Victor F. Gothberg

I.

That Victor F. Gothberg, an individual doing business as Gothberg Construction Company, at the

special instance and request of the defendant R. W. Kelsey and with the knowledge and consent of the defendant Alice Roberts Kelsey, furnished certain building materials for use in the construction, alteration and repair of the building located upon the above-described real property; that the reasonable value of said materials is $2,005.24, and the same were furnished on or about the 15th day of September, 1951.

II.

That on the 20th day of November, 1951, and within ninety (90) days after the last day upon which said materials were furnished, Victor F. Gothberg duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was duly recorded in Book 123 at Page 92 of City Records.

III.

That on December 14, 1951, said Victor F. Gothberg filed a Cross-Complaint in the above-entitled action to foreclose said lien; that the Cross-Complaint prayed for recovery of the sum of $2,005.24 plus interest thereon at the rate of six per cent (6%) per annum from October 15, 1951; $14.00 for the preparation and recording of the statement of lien; costs and disbursements and a reasonable attorney's fee.

IV.

That no part of said lien or of the monies prayed

for in said Civil Action No. A-7261 has been paid, and all of the same is now due and owing to the said Victor F. Gothberg.

L. United States of America

I.

That on the 16th day of July, 1952, the United States of America filed its Notice of Tax Lien in the sum of $18,335.57 against the defendants, R. W. Kelsey and Alice Roberts Kelsey, and the above-described property, for delinquent income taxes, the same being Commissioner's No. 1621.

II.

That on the 2nd day of September, 1952, the United States of America filed its Notice of Tax Lien in the sum of $710.87 against the defendants, R. W. Kelsey and Alice Roberts Kelsey, and the above-described property, for delinquent withholding taxes and FICA, the same being Commissioner's No. 1638.

III.

That no part of said liens has been paid, and all of the same is now due and owing to the said United States of America.

M. R. T. Schultz and J. R. Peck

I.

That R. T. Schultz and J. R. Peck on the 10th day of October, 1951, secured a judgment against the defendants, R. W. Kelsey and Alice Kelsey, in the District Court for the Territory of Alaska,

Third Division, No. A-6899 in the amount of $939.37 plus interest on that sum at the rate of six per cent (6%) per annum from the 18th day of May, 1951, together with costs and disbursements in such action incurred including an attorney's fee allowed by the court in the sum of $250.00.

II.

That the judgment secured by R. T. Schultz and J. R. Peck as above set forth was filed for record in the office of the U. S. Commissioner, Anchorage Recording Precinct, on the 10th day of October, 1951, which was within the four months' period immediately preceding the date on which the said R. W. Kelsey and Alice Roberts Kelsey were adjudged bankrupts.

III.

That no part of the monies prayed for in said Civil Action No. 6899 has been paid, and all of the same is now due and owing to the said R. T. Schultz and J. R. Peck.

N. Sullens & Hoss, Inc.

I.

That on the 9th day of December, 1949, in the District Court for the Territory of Alaska, Third Judicial Division, Sullens & Hoss, Inc., was awarded judgment against the Western American Dredging Corporation, Spenard Lumber Company, and Thomas Kelsey in the sum of $1,676.89 principal, $125.70 interest, $240.00 attorney's fees, and a further sum of $30.00 court costs incurred in that ac-

tion, which was No. 5504; that the said Thomas Kelsey referred to in the above-mentioned judgment is one and the same person as R. W. Kelsey.

II.

That the above-mentioned judgment has never been docketed in the office of the U. S. Commissioner and ex-Officio Recorder for the Anchorage Precinct, Territory of Alaska.

III.

That no part of the monies prayed for in said Civil Action No. 5504 has been paid, and all of the same is now due and owing to the said Sullens & Hoss, Inc.

IV.

That Sullens & Hoss, Inc., at the special instance and request of R. W. Kelsey and Alice Roberts Kelsey, furnished lumber and building material used upon the above-described property; that the reasonable value of said materials is $442.50, and the same were furnished between July 5, 1951, and July 24, 1951.

V.

That the sum of $90.00 has been paid, leaving a balance of $352.50; that on the 31st day of August, 1951, and within ninety (90) days after the last day upon which materials were furnished, Sullens & Hoss, Inc., duly filed for record and caused to be recorded in the office of the U. S. Commissioner, Anchorage Recording Precinct, a statement of lien against the above-described property, which lien was

duly recorded in Book 118 at Page 8 of City Records.

VI.

That during the month of September, 1951, the defendants, R. W. Kelsey and Alice Roberts Kelsey, paid to Sullens & Hoss, Inc., the sum of $376.57.

VII.

That on November 14, 1951, said Sullens & Hoss, Inc., filed a Cross-Complaint in the above-entitled action to collect said judgment and foreclose said lien; that said Cross-Complaint alleged that the payment of $376.57 should be applied against the judgment entered in Cause No. 5504; that it should recover the sum of $1,685.13 plus interest at the rate of six per cent (6%) per annum from the 9th day of December, 1949, upon said judgment; that it should recover the sum of $352.50 upon said lien, together with interest at the rate of six per cent (6%) per annum from the 31st day of August, 1951, and the further sum of $3.75, the cost of filing the lien of record; for costs and a reasonable attorney's fee.

VIII.

That the payment made by the defendants during the month of September, 1951, was in payment of the lien filed against the above-entitled property.

O. General

I.

That the following persons or firms have filed notices of liens against the above-described prop-

erty with the U. S. Commissioner and ex-Officio Recorder for the Anchorage Recording Precinct, Territory of Alaska, and constitute a cloud upon the title to the above-described property, but no action has been instituted within six months from the date of filing, as required by law:

Name	Dated Filed	Amount
Alaska Art Tile & Alaska Building Supply	9/13/49	$ 220.50
North Star Appliance	10/12/51	1071.00
J. C. Floor Covering	10/23/51	182.07
Anchorage Sash and Door	11/10/51	97.00
William Olday*	12/ 6/51	120.00
William Olday*	12/ 6/51	110.00

*One of these has been paid.

II.

That judgment in favor of the City of Anchorage and against R. W. Kelsey was entered in Case No. 4-360, U. S. Commissioner's Court, Anchorage Precinct, on September 24, 1951, for the sum of $257.12 principal, $25.00 for attorney's fees and $18.20 court costs; that said judgment is docketed in JD 3 at Page 14 of the records of the U. S. Commissioner.

III.

That judgment in favor of Rodney H. Vore and Marie Vore and against R. W. Kelsey and Alice Roberts Kelsey was entered in Case No. 4-370, U. S. Commissioner's Court, Anchorage Precinct, Territory of Alaska, on October 24, 1951, for the sum of

$290.00 plus interest thereon at the rate of six per cent (6%) per annum from September 1, 1951, until paid, $43.50 for attorney's fees and $22.60 court costs; that said judgment is docketed in JD 3 at Page 31 of the records of the U. S. Commissioner.

Submitted this 9th day of June, 1953.

/s/ J. L. McCARREY, JR.,
Attorney for Irene Arnold, Bill's Electric Supply and Service Shop, Ken Luse & Company, Henry F. Wollf, Inc., and Kincaid & King Construction Co., Inc.

Receipt of copy acknowledged.

[Endorsed]: Filed June 9, 1953.

[Title of District Court and Cause.]

OPINION

Filed August 27, 1953

J. L. McCARREY, JR.,
Attorney for Plaintiff.

CUDDY & DUNN,
Attorneys for Heine Berger, Ketchikan Spruce Mills, D. H. Cuddy, Trustee.

J. L. McCARREY, JR.,
Attorney for Kincaid & King Construction Co., Inc.; Ken Luse & Company; William Stolt and Lilian Stolt.

BELL & SANDERS,
Attorneys for Sullens & Hoss.

DAVIS, RENFREW & HUGHES,
Attorneys for Victor F. Gothberg, R. T. Schultz and J. R. Peck.

KAY, ROBISON & MOODY,
Attorneys for William Olday and Henry W. Cuffel.

EVANDER C. SMITH,
Attorney for J. C. Floor Covering.

SEABORN J. BUCKALEW,
U. S. Attorney, and

ARTHUR D. TALBOT,
Assistant U. S. Attorney for the United States.

This suit for the foreclosure of plaintiff's mortgage against the real property of the defendants, Alice and R. W. Kelsey, husband and wife, involves the rank and priority of the mortgage lien and the liens claimed against the same property by the other defendants. The principal contest is between the lien of the mortgage given the plaintiff by the defendant, Alice Kelsey, and the lien of the judgment of the defendant, Sullens & Hoss.

It appears that on September 17, 1949, the defendant, Alice Kelsey, record owner, gave the plaintiff a mortgage on the property involved to secure a loan of $5,000 which was later consolidated with other loans aggregating $16,609.51, for which another mortgage was given the plaintiff by the Kel-

seys. On December 9, 1949, the defendant Sullens & Hoss obtained a judgment for $1,676.89 in this court against the Western Dredging Corporation, Spenard Lumber Company and the defendant R. W. Kelsey. On January 25, 1952, the Kelseys were adjudged to be bankrupts.

The plaintiff contends that the judgment lien was not perfected because a transcript of the docket entry thereof was not filed in the office of the Recorder for Anchorage Precinct, whereas the defendant Sullens & Hoss contends that it is only when the judgment creditor desires to subject to his lien property situate elsewhere in the Territory than in the Division in which the judgment is entered, that the transcript must be filed in the particular recording district, in accordance with the provision of Section 55-9-61 ACLA 1949. I am of the opinion that the construction urged upon the Court by the defendant is the correct one. This view finds further support in the construction given the statute by the Courts of Oregon, from which the statute was taken, Creighton v. Leeds, 9 Or. 215 (1881). In any event the judgment obtained by Sullens & Hoss is not a lien against the property involved in this action since Alice Kelsey, the record owner of the property, was not a party to the suit in which the Sullens and Hoss judgment was obtained.

The contention has been made that the first mortgage is invalid, and hence that liens of other creditors arising before the filing of the second mortgage are superior to the entire debt owed the plaintiff.

Such invalidity is claimed on the ground that the mortgage was not signed by the husband of the mortgagor, Alice Kelsey—a prerequisite under Sec. 22-3-1 ACLA 1949 to the validity of a conveyance of property which includes the homestead. Assuming that a mortgage is a conveyance and that the property was used in part as a home by the Kelseys, Cf. Wendler v. Brennaman, 7 Alaska 13, it nevertheless appears to be the law that the objection interposed is not available to a third person but only to the possessor of the homestead right. Davis v. Low, 135 Pac. 314 (Or.); 5 Tiffany on Real Property 154. And this rule is not affected by adjudication in bankruptcy. 11 USCA 24.

It is also contended that the mortgage of September 17, 1949, was extinguished by the later mortgage. I find, however, that there was no release or satisfaction of the lien of the first mortgage; that there was merely a consolidation of the loans and the taking of the new mortgage, with no intention that the lien of the first mortgage should be relinquished, and hence conclude, in the absence of any showing of prejudice, that there was no extinguishment, Griffin v. International Trust Co., 169 Fed. 48 (9th Cir.); that the plaintiff's lien of $5,000 is entitled to priority over all other liens, and that the remaining liens and claims should be paid in the following order:

1. Ketchikan Spruce Mills.
2. Kincaid & King.
3. H. Berger.

4. Irene Arnold.
5. Wm. & L. Stolt.
6. Ken Luse, Henry Wolff, Inc., equal rank.
7. Dan Cuddy, Trustee.
8. Henry W. Cuffel.
9. R. H. & Marie Vore.
10. V. Gothberg.
11. City of Anchorage.
12. R. T. Schultz & J. R. Peck.
13. United States.
14. United States.

I further find from the uncontradicted testimony of the plaintiff that the payment of $376.57 to the defendant Sullens & Hoss was applied on its lien of July 24, 1951.

/s/ GEORGE W. FOLTA,
District Judge.

[Endorsed]: Filed August 27, 1953.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause came on regularly for hearing in open court on the 29th day of June, 1953, upon presentation of Statement of Facts submitted by J. L. McCarrey, Jr., attorney for plaintiff; the plaintiff, Irene Arnold, was present in court and represented by J. L. McCarrey, Jr., her counsel; the defendants, Alice Roberts Kelsey and R. W. Kelsey,

neither appeared in person nor were they represented by counsel; that personal service was made upon said defendants on the .... day of October, 1951, according to law; that the defendants, Heine Berger, Ketchikan Spruce Mills, and D. H. Cuddy, Trustee, were represented by the firm of Cuddy & Dunn; that the defendants, William Olday and Henry W. Cuffel were represented by the firm of Kay, Robison and Moody; that the defendant, Sullens & Hoss, Inc., was represented by the firm of Bell & Sanders; that the defendants, Victor F. Gothberg, R. T. Schultz and J. R. Peck, were represented by the firm of Davis, Renfrew & Hughes; that the defendant, United States of America, was represented by the U. S. Attorney, Anchorage, Alaska; that the defendants, Kincaid & King Construction Co., Inc., Kenneth W. Luse, William Stolt and Lilian Stolt, and Henry F. Wollf, Inc., were represented by J. L. McCarrey, Jr. The Court proceeded to hear the evidence produced by the plaintiff in support of the Statement of Facts, and the evidence of the defendants, and being fully advised in the premises now makes the following Findings of Fact:

I.

That the Statement of Facts prepared by the plaintiff represents a true statement of the facts involved in this action.

II.

That the judgment obtained by Sullens & Hoss, Inc., is not a lien against the property involved in

this action since Alice Roberts Kelsey, the record owner of the property, was not a party to the suit in which the Sullens & Hoss, Inc., judgment was obtained.

III.

That the mortgage of September 17, 1949, given by Alice Roberts Kelsey to Irene Arnold, was not extinguished by the later mortgage of December 22, 1950, but remained in full force and effect.

IV.

That the payment of $376.57 by the defendants Alice Roberts Kelsey and R. W. Kelsey to the defendant Sullens & Hoss, Inc., was applied on its lien of July 24, 1951.

V.

That the real property concerned in this action has been sold under a stipulation entered into by the parties hereto for the sum of $35,000.00, which sum is being held subject to all the rights and claims the parties hereto previously had against the real property.

From the above and foregoing findings of fact, the Court enters the following, its

Conclusions of Law

I.

That the plaintiff's lien of $5,000.00 is entitled to priority over all other liens, and that said liens and claims, together with interest and costs, should be paid in the following order:

Name	Principal	Interest	Filing Fee	Filing Lien	Marshal Fee	Attorney Fee
1. Irene Arnold	$ 5,000.00	$ 829.97	$27.00	$	$28.80	$941.50
2. Ketchikan Spruce Mills	250.00	56.50	27.00	3.75	58.50*	91.95
3. Kincaid & King Const. Co.	408.25	69.59	27.00	5.75	6.80	143.35
4. Heine Berger	1,959.22	424.49				507.56
5. Irene Arnold	10,344.81	1,784.07				392.58
6. William & Lilian Stolt	140.18	17.78		6.50	26.00	47.39
7. Kenneth W. Luse	2,375.05	298.40		6.00	26.00	551.02
Henry F. Wollf, Inc.	566.11	71.13		3.75	26.00	191.17
8. D. H. Cuddy, Trustee	4,131.00	677.87				871.33
9. Henry W. Cuffel	1,240.00					
10. R. H. and Marie Vore	290.00	34.80	22.60			43.50
11. Victor Gothberg	2,005.24	225.58				484.62
12. City of Anchorage	257.12	29.89	18.20			25.00
13. R. T. Schultz & J. R. Peck	939.37	128.92	27.00			250.00
14. United States	18,335.57					
15. United States	710.87					

*For Ketchikan, Berger and Cuddy.

II.

That the amounts and claims set forth in Paragraph I of these Conclusions of Law be paid from the sum of $35,000.00 derived from the sale of the real property involved in this action, insofar as possible.

III.

That no other or further relief need be granted.

Done in Open Court at Anchorage, Alaska, this 4th day of September, 1953.

/s/ GEORGE W. FOLTA,
Judge of the District Court.

Receipt of copy acknowledged.

[Endorsed]: Filed September 4, 1953.

In the U. S. District Court for the District of Alaska, Third Division

No. A-7261, A-6132, A-7063 and A-7131

Consolidated Actions

IRENE ARNOLD,

Plaintiff,

vs.

ALICE ROBERTS KELSEY and R. W. KELSEY, Husband and Wife; HEINE BERGER; ALASKA ART TILE AND BUILDING SUPPLY; KETCHIKAN SPRUCE MILLS; KINCAID & KING CONSTRUCTION CO., INC.; KEN LUSE & COMPANY; WILLIAM

STOLT and LILIAN STOLT, d/b/a BILL'S ELECTRIC SUPPLY AND SERVICE SHOP; D. H. CUDDY, Trustee for PAT RYAN, ERMA SCHULER, V. W. GARRISON and ALASKA PLUMBING AND HEATING CO., INC.; HENRY W. CUFFEL, d/b/a NORTHERN NEON SIGN CO.; SULLENS & HOSS, INC.; JOHN DOE and RICHARD ROE,

Defendants.

JUDGMENT

The above-entitled cause came on regularly for hearing in open court on the 29th day of June, 1953, upon presentation of Statement of Facts submitted by J. L. McCarrey, Jr., attorney for plaintiff; the plaintiff, Irene Arnold, was present in court and represented by J. L. McCarrey, Jr., her counsel; the defendants, Alice Roberts Kelsey and R. W. Kelsey, neither appeared in person nor were they represented by counsel; that personal service was made upon said defendants on the 16th day of October, 1951, according to law, and that the default of said defendants for their failure to appear and plead to plaintiff's Complaint has been heretofore entered by this Court; that the defendants, Heine Berger, Ketchikan Spruce Mills, and D. H. Cuddy, Trustee, were represented by the firm of Cuddy & Dunn; that the defendants, William Olday and Henry W. Cuffel, were represented by the firm of Kay, Robison and Moody; that the defendant, Sul-

lens & Hoss, Inc., was represented by the firm of Bell & Sanders; that the defendants, Victor F. Gothberg, R. T. Schultz and J. R. Peck, were represented by the firm of Davis, Renfrew & Hughes; that the defendant, United States of America, was represented by the U. S. Attorney, Anchorage, Alaska; that the defendants, Kincaid & King Construction Co., Inc., Kenneth W. Luse, William Stolt and Lilian Stolt, and Henry F. Wollf, Inc., were represented by J. L. McCarrey, Jr.; and the Court, being fully advised in the premises, having heretofore made and filed herein its Findings of Fact and Conclusions of Law in this matter, and having directed that judgment be entered in accordance therewith:

Now, Therefore, by reason of the law and the findings aforesaid,

It Is Hereby Ordered, Adjudged and Decreed as follows:

1. That the plaintiff's lien of $5,000.00 is entitled to priority over all other liens, and that said liens and claims, together with interest and costs, should be paid in the following order:

Name	Principal	Interest	Filing Fee	Filing Lien	Marshal Fee	Attorney Fee
1. Irene Arnold	$ 5,000.00	$ 829.97	$27.00	$	$28.80	$941.50
2. Ketchikan Spruce Mills	250.00	56.50	27.00	3.75	58.50	91.95
3. Kincaid & King Const. Co.	408.25	69.59	27.00	5.75	6.80	143.35
4. Heine Berger	1,959.22	424.49				507.56
5. Irene Arnold	10,344.81	1,784.07				392.58
6. William & Lilian Stolt	140.18	17.78		6.50	26.00	47.39
7. Kenneth W. Luse	2,375.05	298.40		6.00	26.00	551.02
Henry F. Wolff, Inc.	566.11	71.13		3.75	26.00	191.17
8. D. H. Cuddy, Trustee	4,131.00	677.87				871.33
9. Henry W. Cuffel	1,240.00					
10. R. H. and Marie Vore	290.00	34.80	22.60			43.50
11. Victor Gothberg	2,005.24	225.58				484.62
12. City of Anchorage	257.12	29.89	18.20			25.00
13. R. T. Schultz & J. R. Peck	939.37	128.92	27.00			250.00
14. United States	18,335.57					
15. United States	710.87					

2. That the above set forth claims and amounts be paid from the sum of $35,000.00 derived from the sale of the real property involved in this action, insofar as possible.

Done in Open Court at Anchorage, Alaska, this 4th day of September, 1953.

/s/ GEORGE W. FOLTA,
Judge of the District Court.

[Endorsed]: Filed and entered September 4, 1953.

[Title of District Court and Cause.]

NOTICE OF APPEAL
(Victor F. Gothberg)

Notice is hereby given that Victor F. Gothberg, an individual doing business as Gothberg Construction Company, one of the cross-complainants in the above-entitled matter, hereby appeals to the United States Court of Appeals for the Ninth Circuit from that certain decree entered in the above-entitled matter on the 4th day of September, 1953.

That such decree was the final judgment in the above-entitled matter and that such decree purported to establish priorities of payment between mortgages and certain liens all as will more fully appear from such decree.

Dated at Anchorage, Third Judicial Division, Territory of Alaska, this 2nd day of October, 1953.

DAVIS, RENFREW & HUGHES,

Attorneys for Cross-Complainant Victor F. Gothberg.

By /s/ EDWARD V. DAVIS.

Receipt of copy acknowledged.

[Endorsed]: Filed October 2, 1953.

[Title of District Court and Cause.]

NOTICE OF APPEAL
(Sullens & Hoss)

Comes now one of the above-named defendants, Sullens & Hoss, Inc., a Corporation, and files this, its Notice of Appeal, from a final Judgment rendered in the District Court for the District of Alaska, Third Division, on the 4th day of September, 1953, said appeal to be taken from this Court to the United States Court of Appeals, Ninth Circuit, San Francisco, California.

Dated at Anchorage, Alaska, this 5th day of October, 1953.

BELL & SANDERS,

By /s/ BAILEY E. BELL,

Attorneys for Sullens & Hoss, Inc., a Corporation.

Receipt of copy acknowledged.

[Endorsed]: Filed October 5, 1953.

[Title of District Court and Cause.]

ORDER EXTENDING TIME TO FILE AND DOCKET RECORD ON APPEAL

Davis, Renfrew & Hughes, attorneys for appellant Victor F. Gothberg, having made application for additional time in which to docket and file record on appeal and it appearing that the Court intends to be absent from Anchorage, Alaska, on November 9th and 10th and November 11th, which is a holiday, and it further appearing that good cause exists for extending time to file and docket record on appeal in this matter and that this Court has jurisdiction to grant the extension herein named and the Court being fully advised in the premises,

Now, Therefore, it is hereby ordered, adjudged and decreed that Victor F. Gothberg, appellant, may have to and including the 26th day of November, 1953, to file and docket record on appeal in the above-entitled matter.

Dated at Anchorage, Alaska, this 7th day of November, 1953.

/s/ J. L. McCARREY, JR.,
District Judge.

[Endorsed]: Filed and entered November 7, 1953.

[Title of District Court and Cause.]

ORDER FURTHER EXTENDING TIME TO FILE AND DOCKET RECORD ON APPEAL

Davis, Renfrew & Hughes, attorneys for appellant Victor F. Gothberg, and Bailey E. Bell, attorney for appellants Sullens & Hoss, Inc., having made application for an additional extension of time in which to docket and file record on appeal in the above-entitled matter, and it appearing to the court that notice of appeal was filed on behalf of Victor F. Gothberg on the 2nd day of October, 1953, and by Sullens & Hoss on October 5th, 1953, and it further appearing that such parties heretofore and on or about the 12th day of November, 1953, designated the entire record as the record on appeal and directed the clerk of this court to forward such record to the court of appeals at San Francisco, and it further appearing that such record has not been forwarded by the clerk to San Francisco, and is now in the hands of the District Attorney at Anchorage, Alaska, and it further appearing that ninety days have not elapsed since the filing of notice of appeal and that this court has authority to extend the time for docketing the appeal as provided by the Federal Rules of Civil Procedure, and it appearing that the court on the 7th day of November, 1953, extended the time for filing and docketing the record on appeal in this matter to the 26th day of November, 1953, and the

court being fully advised in the premises, now, therefore, it is hereby

Ordered, Adjudged and Decreed that Victor F. Gothberg and Sullens & Hoss, Inc., two of the above-named appellants, may have an additional time to and including the 10th day of December, 1953, to file and docket the appeal in the above-entitled matter.

Dated at Anchorage, Alaska, this 25th day of November, 1953.

/s/ J. L. McCARREY, JR.,
District Judge.

[Endorsed]: Filed and entered November 25, 1953.

In the District Court for the District of Alaska, Third Division

(Consolidated)—No. A-7261, No. A-7063 and Nos. A-7131, A-6132

IRENE ARNOLD,

Plaintiff,

vs.

ALICE ROBERTS KELSEY and R. W. KELSEY, Husband and Wife; HEINIE BERGER; ALASKA ART TILE AND BUILDING SUPPLY; KETCHIKAN SPRUCE MILLS; KINCAID AND KING CONSTRUCTION

COMPANY, INC.; KEN LUSE & COMPANY; WILLIAM STOLT and LILIAN STOLT, d/b/a BILL'S ELECTRIC SUPPLY AND SERVICE SHOP; D. H. CUDDY, Trustee for PAT RYAN, ERMA SCHULER, V. W. GARRISON and ALASKAN PLUMBING AND HEATING CO., INC.; HENRY W. CUFFEL, d/b/a NORTHERN NEON SIGN CO.; SULLENS & HOSS, INC.; FRED GERKEN and BERNARD GOLLOMP, HUNT & MOTTET CO.; J. R. PECK and R. T. SHULTZ and VICTOR GOTHBERG, d/b/a GOTHBERG CONSTRUCTION COMPANY, and HENRY F. WOLLF, INC.,

Defendants.

KINCAID & KING CONSTRUCTION COMPANY, INC., an Alaskan Corporation,

Plaintiff,

vs.

ALICE ROBERTS KELSEY and ROYAL W. KELSEY, et al.,

and

UNITED STATES OF AMERICA,

Defendants.

TRANSCRIPT OF PROCEEDINGS

June 15, 1953—1:30 P.M.

Before: The Honorable George W. Folta,
United States District Judge.

Appearances:

J. L. McCARREY, JR., and
MRS. JANET WILSON,
Attorneys for the Plaintiff Irene Arnold and Defendant Kincaid and King Construction Company, Inc., in Cause No. A-7261; for Plaintiff Kincaid and King Construction Company, Inc., in Cause No. A-7063; for Defendant Ken Luse & Company and Defendant Henry F. Wollf, Inc.

JOHN C. DUNN, of
CUDDY AND DUNN,
Attorney for Defendants Heinie Berger; Ketchikan Spruce Mills; William Stolt and Lilian Stolt, d/b/a Bill's Electric and Service Shop; D. H. Cuddy, Trustee for Pat Ryan, Erma Schuler, V. W. Garrison and Alaskan Plumbing and Heating Co., Inc.

WENDELL P. KAY, of
KAY, ROBISON & MOODY,
Attorney for Defendants Henry W. Cuffel, d/b/a Northern Neon Sign Co.; William Olday; Fred Gerken and Bernard Gollomp, Hunt & Mottet Co.

BAILEY E. BELL, of
BELL & SANDERS,
Attorney for Defendants Sullens and Hoss, Inc.

EDWARD V. DAVIS, of
DAVIS, RENFREW & HUGHES,
Attorney for Defendants J. R. Peck, R. T. Shultz and Victor Gothberg, d/b/a Gothberg Construction Company.

EVANDER C. SMITH,
Attorney for Defendant J. C. Floor Covering.

ARTHUR D. TALBOT,
Asst. U. S. Attorney, Attorney for Defendant United States of America.

The Court: I am unable to determine from the file here just the precise nature of the stage of this case, what is before the Court.

Mr. McCarrey: Your Honor, in this case the record will show that the original case of Irene Arnold vs. Kelsey, et al., was filed on the 15th day of October, 1951, to foreclose a mortgage which had been issued on the 25th day of January—correction, 16th day of January, 1951. Thereafter there were numerous lien claimants who came in and joined in this case and while I did not have an opportunity to check the file I think counsel will admit all of those actions, by order of the Court, both in written form as well as a minute order, were all consolidated. Now, on the 25th day of January, 1952, the

defendants, Alice and this other Kelsey, her husband, were adjudicated bankrupt. Now, further in the case, for and on behalf of Mrs. Arnold and others that the mortgagees and the various lien claimants have the right to proceed against the property itself or against the writs predicated upon the premise precedent, that they were at least four months and prior to the adjudication of bankruptcy and it is our understanding of the facts in this case that that is the case.

Now, this is to be determined, as we understand it, aside from the bankruptcy proceedings in its entirety and the purpose of this notice of motion and of the motion itself is to at this time have the parties accept the statement of facts heretofore prepared [4*] by our office unless there are objections thereto which the Court will consider and to determine at this time the priority of liens.

The Court: I overlooked the notice of the motion itself. There isn't any motion of hearing in the file.

Mr. McCarrey: Notice of the motion.

The Court: There is a notice of it?

Mr. McCarrey: Yes.

The Court: Are all the defendants represented here?

Mr. McCarrey: I think they are, your Honor, as far as I know.

Mr. Davis: Kelsey is in default.

Mr. McCarrey: Excepting for the Kelseys themselves.

***Page numbering appearing at foot of page of original Reporter's Transcript of Record.**

The Court: Have you been served with a copy of the objections to the statement of fact?

Mr. McCarrey: Just to one, just now, your Honor.

The Court: Perhaps you better glance over it and——

Mr. McCarrey: (Did so.) In that respect, your Honor, nothing is set forth that that judgment was ever filed in the Commissioner's Office. Mr. Bell, can you tell us when it was filed? We have never been able to find it ourselves.

The Court: What judgment do you refer to?

Mr. McCarrey: The judgment he refers to is Sullens & Hoss.

Mr. Bell: It wasn't filed in the Commissioner's Office. It was a better lien in this district court. There is no reason [5] why it would be filed in the Commissioner's Court here in the Third District. If we wanted to change a lien in a special district somewhere outside of the Third, of course, we could take a certified copy of it and file it and create a lien but the statutes specifically provide that it is a lien when filed—when rendered and filed in the Clerk's Office and that's where it was filed. The Section of the statutes 55-9-61 of Alaska Compiled Laws provides that the judgment is a lien—a judgment in the District Court is a lien.

Mr. McCarrey: I wish to correct myself. I meant the records of his office rather than the Commissioner's Office. Now, in that respect, your Honor, the plaintiff, Irene Arnold, takes exception to that proceeding assuming that and we don't admit that

it is the case, for argument purposes that there is a controversy of facts, for this reason, that the lien which was heretofore filed by Mr. Kelsey by Sullens & Hoss was paid for in full. However, in the complaint you will find out that Sullens & Hoss, through their Attorney, Mr. Bell, make a statement that that lien was applied against the judgment and not the lien. We have proof that that is not the case. I don't know what your Honor has in mind by trying that particular issue.

The Court: Am I correct in assuming that the original objections to your statement of facts are the objections just filed?

Mr. McCarrey: Is that correct? [6]

Mr. Dunn: I made two notes and I think we can straighten them out amongst ourselves and I don't know whether I am right or not but I am at variance with the fact as stated. My notes show that under K, the claim of Victor F. Gothberg, the last date in the first paragraph, speaking of these materials, the last of them were furnished on or about the 15th day of September. According to my notes it was the 15th of October and the other is under L, dealing with the United States, the first page of paragraph II, I have that date as the 17th of September instead of the 2d.

Mr. McCarrey: Will you help us on that, Mr. Davis?

Mr. Davis: I can't answer as to a specific date on it.

Mr. Bell: According to the lien attached to the complaint, it would show the date.

Mr. McCarrey: That's only half of it. I call Mr. Dunn's attention to the lien attached to the complaint. It says the 15th day of September, 1951.

Mr. Dunn: I don't know but what those facts are correct. I wanted you to check them because my notes were contrary, just a suggestion.

Mr. McCarrey: According to the lien that is the way it stands. Do you have anything else?

Mr. Dunn: No.

Mr. Davis: What was the second one you mentioned?

Mr. Dunn: The claim of the United States, first date of paragraph II, under Section L, the 17th instead of the 2d. [7]

Mr. McCarrey: Your Honor, based upon the answer just served on us before the hearing Mr. Talbot has pointed out that is the 16th day of July, 1952. I wonder if that would clarify it, Mr. Dunn?

Mr. Davis: 16th is the same day. He is talking about the 17th of September rather than the 2nd of September.

Mr. Dunn: Second paragraph.

Mr. McCarrey: I also call Mr. Dunn's attention then to paragraph II of the answer which provides that it was on the 2d day of September.

Mr. Talbot: I believe it was the 2d day of September.

Mr. Dunn: If Miss Wilson is certain of those dates I make no objection to them. You'll recall that you and I both did quite a bit of work in checking this property at the time of the sale and I took

the information from my notes. Now your check was undoubtedly subsequent to mine.

Miss Wilson: The dates, as I have them, were checked out with the United States of America, Bureau of Internal Revenue, and the records, according to the United States Commissioner's records.

Mr. McCarrey: That should answer it, if that is the case.

Mr. Dunn: I'm making no formal objection.

Mr. Talbot: If your Honor please, the notice of motion which was served upon the United States Attorney, as this is a [8] form unfamiliar to me I am not clear whether this is a proposed stipulation or a pretrial conference or perhaps a motion for summary judgment. In any event I haven't had an opportunity to be advised by the Bureau of Internal Revenue exactly what position they desire to take. I have checked this information so far as I am able to check it and I find that what Mr. McCarrey says as to the Government's dates and the amounts of the liens is correct, but I'm really at a loss to know the nature of the proceedings today, your Honor.

The Court: I don't think we need concern ourselves so much with as you might say the technical aspects of it. I would treat it as a proposed stipulation of fact and the only question is whether the counsel representing the various parties are in agreement or are willing to so stipulate. Now, do you have any objections to this—to a stipulation of that kind?

Mr. Talbot: Well, your Honor, I haven't had a chance to check all this information but with all these attorneys concerned and everyone agreeing I will so stipulate that the facts, as far as they are shown, are correct.

The Court: Well, am I to understand that the only objections are the objections of Sullens & Hoss?

Mr. Bell: I am urging my objections.

The Court: Now, are these objections—you look them over—such as would require a hearing or do you wish to be heard on it or do you wish to submit the matter to the Court [9] without——

Mr. McCarrey: In that respect, your Honor, we would like to be heard by way of testimony as to whether or not the payment on the lien was accepted by Sullens & Hoss to prove that it was taken by way of payment upon the lien and not by way of payment upon the judgment. Now, I don't know how much time Mr. Bell would want.

Mr. Bell: We have no objection to anything now. The record will clarify itself.

The Court: You are willing to rest on your objections as you set them forth here?

Mr. Bell: Yes, sir.

The Court: Well, the procedure would require that you proceed as though he had put in his case.

Mr. McCarrey: May I have just one moment to check on this, your Honor?

The Court: Yes.

Mr. McCarrey: Your Honor and Mr. Bell, calling attention to paragraph 2——

The Court: That's paragraph 2 of what?

Mr. McCarrey: Of the statement of facts—that is on page 10 of the statement of facts. Mr. Bell, I would like to call your attention to paragraph 2 on page 10 of the statement of facts.

Mr. Bell: Paragraph 2 on page 10—all [10] right.

Mr. McCarrey: Now, it is my understanding, based upon your last statement, that you would be willing to admit that this has never been recorded in the records office, is that correct?

Mr. Bell: I admit that it is a judgment rendered in open court and the decree signed and filed in the District Court and was duly entered and the judgment roll made up there as the records show in the office of the District Court and that there was no filing of anything before the United States Commissioner or ex-officio records.

Mr. McCarrey: That being the case then you don't except to that fact?

Mr. Bell: You say that it does not constitute a lien? Well, that's what I except to. That is a conclusion of law. I say that it did. When it was filed by the Clerk of the District Court, like the statutes said, it becomes a lien on everything.

Mr. Dunn: If your Honor please, my proposed suggestion is that we strike so much of the statement that says, "does not constitute a lien," and we can stipulate that the judgment was docketed in the District Court but that it was neither docketed nor recorded in the Commissioner's Court and having so amended this, submit the question to the

Court to decide whether or not such a docketing in the District Court or in the Commissioner's Court constitutes a lien.

The Court: I think that has probably been the practice under the stipulation, that is, improper to include in a [11] stipulation a matter of law and therefore we may just eliminate that.

Mr. McCarrey: That is satisfactory.

Mr. Bell: If you will strike that part that will settle it. Then it will be a question for you to determine whether it constitutes a lien or not.

Mr. McCarrey: I was going to come to that next but I believe Mr. Bell summed it up.

The Court: Very well. That will be stricken then.

Mr. McCarrey: Now, your Honor, we have the next question to determine, whether or not this sum of $376.53 was ever paid upon the older debt or upon a lien they had at that time and at this time we are prepared to go ahead and present testimony on that point. I imagine it won't take more than one moment.

The Court: Very well. You may do that.

Mr. McCarrey: At this time I call Mrs. Irene Arnold.

IRENE ARNOLD

called as a witness in her own behalf as plaintiff, and, being first duly sworn, testified as follows on:

Direct Examination

By Mr. McCarrey:

Q. Will you state your name, please?

A. Irene Arnold.

Q. And are you the plaintiff in this cause of action or Irene [12] Arnold vs. Alice Roberts Kelsey and R. W. Kelsey, A-7261? A. Yes.

Q. Now, calling your attention to the fall of 1951, did you have an occasion to talk to Mr. Kelsey about this matter concerning the payment of a lien with Sullens & Hoss?

Mr. Bell: I object to that she talked to Mr. Kelsey unless the Sullens & Hoss were present or their agent. Why the conversation would not be——

Mr. McCarrey: Your Honor, she has not testified to the conversation. If counsel will give me a chance. Did you have occasion to talk to him?

A. Yes, sir.

Q. Now, at that time, did you see a piece of paper from the office of Sullens & Hoss?

A. No. I saw a piece of paper from Mr. Bell's office, signed by Mr. Bell.

Q. What did that piece of paper state?

Mr. Bell: I object to that. The piece of paper itself would be the best evidence.

The Witness: It was typewritten.

Mr. Bell: I object to that.

(Testimony of Irene Arnold.)

The Court: The objection will have to be sustained if you call for the contents of the paper unless you can show that it has been lost or something or not available.

The Witness: Mr. Kelsey kept it so I [13] didn't——

Mr. Bell: I object to her making a statement. You have already ruled.

Mr. McCarrey: Mr. Bell, do you have such a piece of paper?

Mr. Bell: I was just trying to see if I have anything.

Mr. McCarrey: If so, we make demand upon you to produce it.

The Court: Well, you may ask the witness if she knows.

Mr. Bell: I guess I have a copy of it right here, maybe, this is probably it, the only one I know about.

Q. (By Mr. McCarrey): This is the piece of paper to which you were referring?

A. No, sir.

Q. What did that refer to, if you recall?

A. Which? This?

Q. No, the one that you were referring to.

A. No, it was simply a receipt for a certain sum of money, this $307 and some odd dollars and Mr. Kelsey wanted me to understand that that had been paid.

Mr. Bell: I object to her testifying to hearsay.

(Testimony of Irene Arnold.)

The Court: I think the objection will have to be sustained.

Mr. McCarrey: Your Honor, in this case we would like to submit this as evidence showing what the intent was and why the defendant was by the office of Mr. Bell. [14]

Mr. Bell: No objection to the letter being introduced. It is a copy of a letter.

The Court: It may be admitted.

(Thereupon, copy of letter, dated September 7, 1951, was received in evidence and marked Plaintiff's Exhibit 1.)

Q. (By Mr. McCarrey): Mrs. Arnold, did you have an occasion thereafter to go up to the office of Sullens & Hoss? A. Yes.

Q. And for what purpose?

A. Well, I had been getting quite a lot of materials from them and asking questions for certain things I needed for this building and so forth, so I, on one occasion, I purposely just wanted to find out so I said to the bookkeeper——

Q. Find out what? What do you mean?

A. I wanted to find out whether or not there was any indebtedness there against the Kelsey Estate.

Q. Yes. A. So I asked him if they——

Mr. Bell: I object to her talking unless—this is a corporation—unless she was talking to someone with authority at the corporation. She might have been talking to the porter.

(Testimony of Irene Arnold.)

Q. (By Mr. McCarrey): Who were you talking to? [15]

A. He was a bookkeeper. I can't recall his name right now, quite an odd name, a man with a little mustache.

Q. What did you inquire of him at that time?

Mr. Bell: I object to that for the reason that would not be binding. The bookkeeper telling her something—this is a corporation.

The Court: I think you have to show something as to the extent of the operations of Sullens & Hoss and whether there were any considerable number of officers in the corporation above the bookkeeper. If just a small outfit presumably the bookkeeper would have knowledge of these matters, otherwise maybe he wouldn't.

Q. (By Mr. McCarrey): Mrs. Arnold, are you familiar with the corporation known as Sullens & Hoss Corporation? A. Am I familiar?

Q. Yes. A. Yes, I know them quite well.

Q. Who are the officers, if you know?

A. Well——

The Court: Who were they at the time?

Q. (By Mr. McCarrey): Yes, who were they at the time?

A. Mr.—I think it was Mr. Hoss. One of them separated from the service, from the corporation, so I think it is Mr. Hoss himself.

Q. And do you know anybody else that was affiliated at that time [16] with the corporation?

A. I don't know whether Mr. Sullens was at that

(Testimony of Irene Arnold.)

time. He separated at a time I didn't know and began to inquire and they told me he was no longer with them.

Q. Who was that? A. Mr. Sullens.

Q. Did you know any of the other officers at that time of that corporation?

A. Yes, I knew this man very well and quite an odd name. I can't recall it.

The Court: What was his officer capacity?

A. He was a bookkeeper.

The Court: Just the two of them, just two there that managed the office?

A. Oh, no; there were a regular office force. I only knew them by sight, the office force. I did know this man. I can't recall his name at this time.

Q. (By Mr. McCarrey): How long had he been working for them? A. A long time.

Q. Do you know what his capacity was?

A. He was—in addition to being more or less a bookkeeper he seemed to be in charge because he was the one that always okayed things and approved.

Q. Did you have occasion to go more than [17] once?

A. Oh, yes; I was in various times; know me very well.

Q. Was he acting in that capacity on these various occasions? A. Yes.

Q. As such do you know whether or not he was familiar with the operation of the Sullens & Hoss corporation? A. Very much so.

(Testimony of Irene Arnold.)

Mr. Bell: Objection.

The Court: The objection will be overruled.

Q. (By Mr. McCarrey): Will you then state, Mrs. Arnold, what he told you about the Kelsey Estate?

A. Well, when I went in one time he said, you are still working with that Kelsey thing. I said, yes, I have to, and I said, did you get yours, and he said, yes, thank goodness we did, and I said, something around $300 some odd dollars, and he said, yes. So that was all he said in that connection.

Mr. McCarrey: That is all.

Cross-Examination

By Mr. Bell:

Q. You did know, Mrs. Arnold, that they were selling lumber occasionally from the Sullens & Hoss yards to this man and his wife out there? You knew they were selling lumber occasionally to them, did you not? [18]

A. No, I had no reason to know.

Q. How come you to go in there and inquire if they had been paid then?

A. Well, because I knew I had seen this piece of paper with your signature, $300 and some odd dollars being paid in full. I saw that. He brought it by and showed it to me.

Mr. Bell: I move to strike that as not responsive to the question—the last part of the answer is not responsive to the question I asked her.

(Testimony of Irene Arnold.)

The Court: It may be stricken.

Q. What they were selling—now, you do know that Sullens & Hoss were selling lumber to the Kelseys, don't you?

A. No, I didn't know it. I had always dealt with them in various things.

Mr. Bell: That's all.

(Thereupon, the witness was excused and retired from the witness stand.)

Mr. McCarrey: Your Honor, that is all we have to present at this time on that point. Now I don't know what the pleasure of the Court would be with reference to the determination of the priority of liens. I ask counsel at this time if they are prepared to stipulate to these statements of fact as——

The Court: Does your proposed stipulation cover priority of these claims? [19]

Mr. McCarrey: No, it does not, your Honor.

The Court: In other words, that is something yet to be determined, is it?

Mr. McCarrey: Yes, your Honor, that is correct.

The Court: Are the parties agreed on the facts then it will be necessary for the Court to have in order to determine the priority?

Mr. Davis: I didn't understand what you said last.

The Court: I said, are the parties agreed on the facts from which priority can be determined?

Mr. Davis: I'm satisfied.

The Court: The facts as set forth in this proposed stipulation?

Mr. Davis: Yes.

Mr. Dunn: Your Honor, I am willing to stipulate that these are the facts but I would like to ask counsel present to go even farther and stipulate that these facts may be submitted without argument of the law concerning them and that they and that we agree now that the Court may decide the priority of these liens from the facts stipulated without any necessity for further hearing or argument at all.

Mr. McCarrey: That is satisfactory.

The Court: Well, then the only other question is that raised by the objections of Sullens & Hoss.

Mr. McCarrey: That is correct, your [20] Honor.

The Court: You wish to be heard?

Mr. Bell: I will state to the Court the truth about that confusion this lady has. I am confident she didn't see any statement of that kind from me but I did give him a statement that she probably did see and I don't have a copy. I tried to dig it up and I don't know where it is but I did give him a real estate mortgage to be executed. I prepared a note and a real estate mortgage and a stipulation whereby that by him paying this amount of money, $300 and some odd dollars, that we would release the lien in full and take the mortgage back for the amount of the judgment, plus interest and attorney's fees as provided in the judgment. The attorney's fees belong to Mr. McCarrey who was the attorney who took the judgment in the case and I

did put that in a stipulation for him with a mortgage that he took out to have his wife to sign it and left the money there with me of this $300 and some odd dollars and he never came back with it. I drove out to the house—Mr. A. E. Hoss and I drove around after him trying to get the mortgage signed to take the place of the old judgment but he wouldn't. He kept stalling me and saying that his wife wouldn't sign it; that he had signed it but she wouldn't sign it; that then that's the last I ever heard from him and then when we couldn't get him to give us the mortgage like he promised to and like his wife promised to give us, why, then, we applied the money on the oldest account, just like we had a right to do, because he didn't go through with his agreement and if he had gone through with the [21] agreement the amount of money he had paid would have been accepted and the lien would have been released. But he didn't go through with it and therefore we didn't release the lien and applied his money on the mortgage. You can see by the cross-complaints and everything that has been set up in all of these cases we gave them a contract with that amount of money on the judgment all the way through, over a year ago, because the money that he turned over to me at the time was applied to the old judgment which was the oldest and the most prior lien. It was a prior lien to all of these other liens because it was a judgment of record in the Clerk's Office. Now, that's the situation as it stands. The lien is in full force and effect in this suit, if this suit is in full force and effect, because they did not go through with the

agreement and still have the real estate mortgage and the note and papers yet; so far as I know, they never did sign them and never did return them to me in compliance with the agreement.

Now, Mr. Hoss is in a cancer hospital in Chicago and I didn't want to delay this on account of that but if they doubt that statement I will get Mr. Hoss here as soon as he gets back out of the hospital and show you that is exactly what took place.

The Court: Do you accept that statement of counsel?

Mr. McCarrey: We do not, your Honor, and furthermore, if Mr. Bell wants that as part of the record, we ask that he be sworn if he is testifying.

Mr. Bell: I am an officer of the Court. I don't have [22] to be sworn. If the Court wishes me to——

The Court: The counsel has a right to insist on that. He has refused to do so, so I think you will have to repeat that statement on the stand.

Mr. Davis: I might ask one question. Maybe clear it up. Is it true there was $300 and some odd dollars paid to you?

Mr. Bell: It was.

Mr. Davis: And apparently then you applied the amount that was paid to the judgment rather than to the lien, is that correct?

Mr. Bell: That is right. Now, do you want me sworn?

The Court: That is up to counsel.

Mr. McCarrey: Your Honor, in that respect, that is for the purpose of the record, he be sworn and let

the testimony stand. The court reporter already has it.

The Court: You mean we would consider his testimony has been given under oath? If you have no objection——

Mr. Bell: It is all right with me.

The Court: You may take the oath then.

(Thereupon, Bailey E. Bell, Sr., took the oath and was sworn in, his previous statement being considered as if having been given under oath.)

Mr. Bell: Now, your Honor, as to no argument, I don't think that Mr. Dunn really meant that exactly as he stated. I don't think so because there is certainly going to be some argument [23] as to priority. There is not enough money to pay everybody, the way I understand it, isn't that right, Mac?

Mr. McCarrey: That is true.

Mr. Bell: And there is quite an argument as to priority.

The Court: I wouldn't want to cut anybody out of an argument but if some of the counsel or parties wish to argue the matter, of course, they will be given an opportunity but it will have to be at some other time. What do you feel about that suggestion?

Mr. Talbot: If your Honor please, I am unable to stipulate to any priority of liens and these matters are ordinarily handled for the government by counsel for the Internal Revenue and I would therefore request 30 days within which the government

may file a brief setting forth the priority of liens as we wish the Court to find.

Mr. McCarrey: Your Honor, I think that is unreasonable—30 days. We have been working on this case now since 1951 and I don't think the government should be granted any more leeway than the taxpayers and therefore I urge the Court not to grant 30 days. That is too much time.

The Court: Who would do the work on behalf of the government?

Mr. Talbot: Mr. Thomas Winter or someone in his office.

The Court: Where is he? [24]

Mr. Talbot: In Seattle, your Honor, and I haven't had a chance to communicate with him in respect to this case. The notice of motion came on or was served on us on the 9th of June and I thought it better to wait and see what it is all about before I wrote him.

The Court: Do you know whether he would want the job of writing the brief or do you know if he would want you to assume it?

Mr. Talbot: No, he would want to write it and I would want him to write it.

The Court: I think two weeks ought to be enough. He ought to be an expert in that line.

Mr. Talbot: Very well, your Honor, I will get in touch with him immediately.

The Court: Does anyone else want to file a brief in this case or make an oral argument at some other time fixed by the Court?

Mr. Davis: I would suggest that before any one

decides to file a brief that you go over the file and give us some idea on what you would like to have help on. I think the statements set forth here are pretty good, would not be too difficult to apply the matter of priorities to any of it except the United States' claim and the claim Mr. Bell has mentioned here.

The Court: Just inform me as to the nature of the United States' claim. What is it for? [25]

Mr. Talbot: Your Honor, we have a claim for income taxes and also for withholding taxes and the total, with penalty and interest, is probably just around $22,000, and it is our—I'm sure it will be our position that the payment of taxes is entitled to a very high priority in bankruptcy.

The Court: Well, you may have two weeks or two weeks will be allowed the United States to file a brief and any other party may file a brief; otherwise, the Court will take the record as it is and if after examination of the record the Court concludes that additional briefs should be filed, it will make an order to that effect.

Mr. Bell: Your Honor, would you make this order that any person in the case who cares to file a brief may have one week to file it and serve it and opposing counsel has five days to answer it and thataway we would get our briefs all in before the government's brief went in and you would have the advantage of them being available.

The Court: That will be the order of Court.

Mr. Dunn: If your Honor please, if we are not going to submit these things with arguments, then

couldn't some provision be made for counsel, other than the counsel of the United States, to answer the brief of the United States when it is submitted? It will come in last.

The Court: The order perhaps should be enlarged to include the right to answer or reply to the brief on behalf of the [26] government, upon making application therefor to the Court.

Mr. McCarrey: Well, a minute order will suffice in that respect, your Honor.

The Court: Yes. That disposes of that stage of this particular case.

United States of America,
Territory of Alaska—ss.

I, Bernice E. Phillips, Official Reporter of the above-entitled Court, hereby certify:

That the foregoing is a full, true and correct transcript of the proceedings in the above-entitled matter taken by me in stenograph in open court at Anchorage, Alaska, on June 15, 1953, and thereafter transcribed by me.

/s/ BERNICE E. PHILLIPS. [27]

June 24, 1953

The Court: Do counsel have a copy of the order entered by the Court?

Mr. McCarrey: I do not, your Honor, but I was advised by the clerk and I do have the questions, I believe, and I think I can submit them to your Honor.

The Court: Well, I don't want them because right here in the minute order——

(The Deputy Clerk left to get the court file.)

The Court: I intended that copies of this minute order would be supplied to counsel but apparently there has been a misunderstanding so I am having the original order or draft of the order obtained from the Clerk's office. I just want to read the text of the minute order so that counsel may have their memories refreshed.

"It is ordered that to determine relative priorities it will be necessary, and therefore it is ordered, that the case be reopened for the production, by plaintiff, of a copy of a mortgage of September 17, 1949, and evidence bearing on the following questions?

"1. Was the first mortgage cancelled or released on the records in the Commissioner's Office? If so, when?

"2. Did plaintiff know at the time the second mortgage was executed, of any liens against [30] the Kelsey property?

"3. Was any attempt made to determine whether there had been any such liens?

"4. Was it intended that the first mortgage should be released when the second one was executed? Did you have any conversation with Kelseys about this?"

You may proceed, Mr. McCarrey.

Mr. McCarrey: At this time I would like to call Mrs. Arnold. She was sworn in; would you like to have her resworn?

The Court: No.

IRENE ARNOLD

recalled as a witness on her own behalf and having been previously sworn, testified as follows on

Direct Examination

By Mr. McCarrey:

Q. You are the same Mrs. Arnold that testified in this hearing the other day? A. Yes.

Q. Mrs. Arnold, I hand you what is purported to be a real mortgage, dated September 17, 1949, and ask you whether or not that is the morgage you executed, that is, made by you to Kelsey? [31]

A. Yes, it is.

Q. Now, has it ever been released?

A. I don't think so.

Q. In the Commissioner's Office? A. No.

Q. Mrs. Arnold, I hand you a chattel mortgage, dated the same date, and ask you whether or not that mortgage, as executed by Mr. Kelsey, for the money you loaned on it, so designates, and whether

(Testimony of Irene Arnold.)

or not in addition it represents an additional $5,000.00 or is it the one and same $5,000.00?

A. It is the same $5,000.00.

Mr. McCarrey: Your Honor, we offer this in evidence, having submitted it to counsel first. You will find, your Honor, that this bears the recommendation of the Commissioner's Office which will speak for itself. While they are looking at the documents, I hand you what purports to be a promissory note and ask you whether that is the promissory note for which these two mortgages were given as security?

The Witness: Yes, sir.

Mr. McCarrey: I likewise offer this in evidence, your Honor.

The Court: What is the amount of that note?

Mr. McCarrey: Five thousand dollars, your Honor.

(Thereupon, the documents above referred to were entered in evidence as Plaintiff's Exhibits 1, 2, and 3.) [32]

Q. (By Mr. McCarrey): Mrs. Arnold, I would like to hand you at this time a real estate mortgage dated 22 December, 1950, and also a promissory note which is purported to have been executed at the same time and will you explain to the Court how that was—why that was executed?

A. Well, Mr. Kelsey said that Mr. Heinie Berger held a mortgage——

Mr. Bell: Object to the statement as not re-

(Testimony of Irene Arnold.)

sponsive to the question. He asked what the instrument was.

Q. Can you explain?

The Court: I think you asked what the circumstances were in making something of that kind. Well, as I have ruled so many times the objection that the answer is not responsive may be made only by the person conducting the examination, so in the absence of another objection on some other ground, the objection, of course, will have to be overruled.

Mr. Bell: I object on the ground it is incompetent, irrelevant and imaterial and it is not responsive in any way.

The Court: I think it is probably hearsay because she commenced to say what someone else said about it.

Q. (By Mr. McCarrey): All right, Mrs. Arnold, on or about the 22nd day of December, 1950, did you have occasion to loan some more money to Mr. Kelsey?

Mr. Bell: Object to her having any occasion. That is not a proper question at all. [33]

Q. Were you asked to loan some money to Mr. Kelsey? A. Yes, I was.

Q. And what amount was that?

A. $8,000.00, so that he could pay off Heinie Berger, therefore, making me the first mortgagor.

Q. Now, were there any other sums that you loaned at the same time?

A. Yes, for another case Reed and Skimer, or something that was in progress then, which he lost

(Testimony of Irene Arnold.)

and I took that up so there would be no other indebtedness over mine.

Q. Now, did Mr. Kelsey pay you back the $5,000.00?

The Court: I didn't quite understand that last answer.

A. There was a case against Mr. Kelsey in court at that time, I think the name was Reed and Skinner, at any rate he lost the case and so there would be no indebtedness preceding mine, I paid that off, which was $3,609.51.

Mr. Bell: $3,609.51?

Mr. McCarrey: Yes.

Q. (By Mr. McCarrey): Now Mrs. Arnold, had Mr. Kelsey paid you back this real mortgage and chattel mortgage that he executed to you in September, 1949?

A. No, he paid a small amount on the interest but nothing on the principal.

Q. Now, is that sum reflected in that second mortgage there? [34]

A. Yes, the entire sum is consolidated here.

Q. Mrs. Arnold, I hand you two checks and ask you whether or not you know what they represent?

A. Yes, I do. It was the sums that I just referred to, the $8,000.00 and the $3,609.51.

Mr. McCarrey: Now, your Honor, should these go in as one exhibit or individually?

The Court: Well, if there is going to be any examination on them separately, they ought to be separately marked.

(Testimony of Irene Arnold.)

Mr. McCarrey: In that event I would like the mortgage be marked Exhibit No. 4, promissory note No. 5, the check for $8,000.00 No. 6 and the check for $3,609.51 No. 7.

The Court: They may be marked accordingly.

(Thereupon, the documents above referred were entered in evidence as Plaintiff's Exhibits 4, 5, 6, and 7.)

Q. (By Mr. McCarrey): Mrs. Arnold, at the time the second mortgage was executed, which was on the 22nd of December, 1950, did you know there were other liens outstanding?

A. No, there wasn't supposed to have been because he was supposed to pay off, with the $8,000.00, all the indebtedness to Mr. Berger.

Q. Did you go check the title to the property yourself in the Commissioner's office? [35]

A. Yes, the title of the property.

Q. Did you go check the books of the title?

A. No, no, he left those with the insurance company and they were the ones that did it and he paid them to do it.

Q. Did you make any attempt aside from that to determine whether or not there were liens against the property?

A. I verified what he said that there were these two liens and this $8,000.00 was supposed to take care of that.

Q. Now, was it intended that the second mortgage was to take the place of the first mortgage?

(Testimony of Irene Arnold.)

A. Yes, absolutely.

Mr. McCarrey: Your Honor, as I recall that represents one of the questions that his Honor had in mind and in reference to this problem if I have overlooked anything would you please advise on that.

The Court: I think it does.

Mr. Bell: I would like to cross-examine, your Honor.

The Court: You may do so.

Cross-Examination

By Mr. Bell:

Q. Mrs. Arnold, how long had you known Alice Roberts Kelsey on the 17th day of September, [36] 1949? A. I would say probably six months.

Q. Was she a relative of yours? A. No.

Q. You had known Mr. Kelsey about how long at that time? A. Oh, about the same time.

Q. And where did they live at that time?

A. They were living in the Spenard Building that was in a very crude state of completion.

Q. Borrow on this particular property involved in the mortgage?

A. That is right, yes.

Q. And about what state of development or completion was the building in at that time?

A. Well, hardly livable for the family.

Q. And there was a store building in it also, wasn't there?

(Testimony of Irene Arnold.)

A. Store building was there, yes, and they were living in a 2-room apartment on the side, very crudely finished.

Q. Do you know who was building the building at that time? A. I understood he was.

Q. And do you know where he was buying the lumber to build it? A. No.

Q. Do you know who was doing the plumbing there? A. No.

Q. Did you inquire of him who was doing the plumbing?

A. Well, he led me to believe that he was doing it himself of necessity from lack of funds. [37]

Q. And you loaned him the money to buy more materials or to by debts that had accumulated against it, did you?

A. That is what he was supposed to do with the money—was to pay for the material.

Q. And did you do the same thing with the second loan? You made another one later, didn't you?

A. Yes, sir.

Q. And that was made to make payments of obligations he owed against the building?

A. That is right.

Q. Now, I understand you to say that he promised you that he would pay this other small mortgage off, it was ahead of ours, out of this $8,000.00 you loaned him. Did he promise to pay that?

A. That was the one of Mr. Berger's?

Q. Yes. A. Definitely.

(Testimony of Irene Arnold.)

Q. Did he ever pay it off, or do you know?

A. He paid one off but not the smaller one.

Q. He paid the mortgage off? A. Yes, sir.

Q. Do you know how much it was?

A. I think approximately $7,000.00.

Q. And then there was another one, a smaller one on there, was there? [38] A. Yes, sir.

Q. Now, were you in the loan business, Mrs. Arnold, at that time? A. I was not, no.

Q. How come you to become acquainted with the Kelseys?

A. Well, it just came to my attention that he couldn't borrow from the bank and he needed it so badly and his family needed better living conditions and I looked out there and saw this and it seemed to me that the lots were paid for and everything was—$5,000.00 would get him started—was just a case of sympathy of the family.

Q. Did you live near Mrs. Kelsey?

A. No, I did not.

Q. Now, you took a chattel mortgage also on the hardware store and equipment and everything, didn't you, including all furniture and fixtures in the place? Was that mortgage ever paid or anything paid on that?

A. Just a small amount on the interest.

Q. Wasn't anything paid on the principal of that?

A. Very small amount. They worked it out and that was the sum. It totaled $16,609.51 balance due.

Q. Now, after that $16,609.51 note and mortgage

(Testimony of Irene Arnold.)

was made, you received quite a number of payments, didn't you? A. Afterwards?

Q. Yes, after the $16,609.51 note was made you received monthly [39] payments for a while, didn't you? A. No, sir.

Q. Did you receive any payments? A. No.

Q. And you are the trustee or you had charge of the building after they left out there, did you not?

A. Yes, sir.

Q. Now, did you get the rent on that building up until the time it was sold?

A. I didn't get the rent. I put the rent into the account of R. W. Kelsey in the bank. I opened an account to them.

Q. Well, now, are those rents in the account of R. W. Kelsey in some bank here? A. Yes, sir.

Q. What bank are they in?

A. The First National.

Q. Are they there in the name of R. W. Kelsey or in your name, as trustee in the bankruptcy matter?

A. R. W. and Alice Roberts Kelsey.

Q. And how much money is there in that account?

A. Well, I have $5,000.00 of the rentals collected.

Q. About $5,000.00? A. Yes, sir.

Q. And, now, you sold the property by agreement of all people. How much did you get for the property? [40] A. $35,000.00.

Q. And is that in the same account?

(Testimony of Irene Arnold.)

A. Yes, sir.

Q. So then you have a little over $40,000.00 in the account? A. Yes, sir.

Q. Was that all the rent you collected up to the time that the property was sold?

A. With the exception of the amount of the indebtedness of my own personal obligations. They were repaid to me of—Mr. McCarrey has a complete copy of all moneys spent.

Q. And how much was that approximately?

A. Well, I would say about $16,000.00, $17,000.00 or $18,000.00. See I had the building all rewired for safety of fire which was over $2,000.00 and they had no money so I had to use my own and pay it off and eventually the rent paid me back.

Q. So you took the $18,000.00 to repay you, did you? A. Yes, sir.

Q. About $18,000.00. Now, about what time was it that you took over this property out there? About what date? Just as nearly as you can get it?

A. Must have been in the fall of '52, '51 I guess.

Q. Fall of '51. Now, where did Kelsey and his wife go, do you know?

A. I took over the property immediately after they left but I was appointed trustee. It was about the fall of '52, '51. [41]

Q. They left here. There was a bankruptcy action filed by them and you were appointed trustee by consent of all the attorneys here, weren't you?

A. Yes, sir.

Q. Now, this $5,000.00 that you are talking

(Testimony of Irene Arnold.)

about, did you collect all of that after you were appointed trustee or was some of that before you were pointed trustee?

A. No, I think all of that was collected afterwards. It was then about $6,000.00, but I had to pay out some—I mean indebtedness—I wanted to settle with everybody, so finally had about $5,000.00.

Q. Now, when did you—who was it you paid these liens off to? What particular liens did you pay off?

A. I didn't pay any liens off except Mr. Olday who was owed $125.00 and he wouldn't excavate or go after the cesspool unless I paid Kelsey's old $125.00 off and that was all the liens.

Q. What was the rest of the $1,000.00 difference between the $5,000.00 and the $6,000.00 used for, as near as you can remember?

A. To thaw pipes and have an electrician working reasonable and fixed another apartment that he had finished and rented that. That helped to increase the rentals so it was all used. It is set forth —I thought all of you attorneys had a copy of [42] that.

Q. No, have you filed a report as Trustee in the bankruptcy case setting up those things? Have you caused a report to be filed in there?

A. Well, I haven't filed a report any more than I set forth from the day I went in and how all the moneys were spent and showing the income and the expenses.

(Testimony of Irene Arnold.)

Q. Where did you file that?

A. Mr. McCarrey, and I thought all the other attorneys had a copy of it. I made quite a few when they had meetings.

Q. I am just informed that you have never filed a report in the bankruptcy proceeding after any of these transactions, is that right?

Mr. McCarrey: That is right.

Q. Now, when you file your report you will include in that report all the things you told us about?

A. Yes, sir.

Q. Have you prepared that, Mr. McCarrey?

Mr. McCarrey: It isn't in final form.

Q. Who has possession of the building now?

A. I can't remember the name of the lady that bought it.

Q. Did you have any interest in it after it was sold, in any way? A. No.

Q. Did you make a loan on it, any more, after that? A. No. [43]

Q. You know what the income, the monthly income, was from the building the last month you held it?

A. It was $1,400.00 and some odd dollars.

Q. $1,400.00. Was it $1,470.00 approximately?

A. Yes, sir.

Q. And had it been that for some time before it was sold, approximately that?

A. Well, it varied. It had gotten down to $800.00 because people would move out of the apartments and were vacant for a time so it varied and

(Testimony of Irene Arnold.)

when some of them found out I was going to sell they were afraid they wouldn't get heat in the building because I had promised it to them if I kept it so they moved out, so the building was not bringing in very much. Actually when it started was three months before the sale was completed so it wasn't bringing in very much. I have forgotten her name that took it over.

Q. But it was refilled right away?

A. I don't know about that because I haven't talked with her. The building was not heated, we just had space heaters in there and not going to be adequate through the winter.

Q. You went out of the Territory of Alaska during the time that you had possession of the building?

A. Oh, yes.

Q. And who took care of it during the time you were gone? A. My daughter. [44]

Q. Your daughter?

A. She collected the rent and did the deposits.

Q. Is she here today? A. Yes, sir.

Q. And now, why didn't you have Mr. Kelsey sign that first real estate mortgage on this property? I noticed it is not signed by Mr. Kelsey at all, but is only signed by Alice?

A. Well, they said that her signature was more important because the land was in her name and not his.

Q. You noticed his name was not mentioned anywhere, is it, and the signature on there?

(Testimony of Irene Arnold.)

A. Well, that's what they said, it was her property, not his.

Q. I see, and you were well acquainted with them, of course, when you loaned them the money, weren't you?

A. No, I never was well acquainted with them.

Q. Well, you were acquainted with them enough, you said, that you felt sorry for them?

A. I did, I would anybody, but they said the lots were worth more than they were asking.

Q. And you did know that they lived there? It was their home? A. Yes.

Q. And you didn't ask Mr. Kelsey to sign the mortgage or the note either one, that first loan?

A. Well, they said it was her property, not his, so her [45] signature was the important one.

Q. And that is what you thought and that is what you took?

A. That is what I thought, yes.

Q. Now, when the second mortgage was made, you had Mr. Kelsey's name included in the mortgage and had him execute it, did you not?

A. Well, he had, I understand, some of the obligations there and it was supposed that he was at that time interested in the building that was being built but the land was hers and that is all it really started with.

Q. Well, you felt that Mr. Kelsey, being the husband of Alice Roberts Kelsey, and being active and having charge of the building, that he should sign the note and mortgage, didn't you?

(Testimony of Irene Arnold.)

A. Yes, sir.

Q. And did you have him sign it now, is that right? A. Yes, sir.

Q. Now, as I understand it, this second mortgage for $16,609.51, that was recorded January 15, 1951—that this $5,000.00 that was secured by the first real estate mortgage, signed by Mrs. Kelsey only, and the chattel mortgage was included in, and made a part of, this second mortgage of $16,609.51?

A. Yes, sir.

Q. And you loaned them enough money in addition to the $5,000.00 to bring it up to that [46] price? A. Yes.

Q. Now, did you ever sell this chattel property out there? A. Which chattel property?

Q. The one secured by the chattel mortgage?

A. No, I didn't.

Q. Did you file a chattel mortgage of record?

A. The $5,000.00?

Q. Yes. A. Yes, sir.

Q. Did you ever release it?

A. No, it wasn't released.

Q. And the hardware store—the stock in the hardware store was included in that mortgage, was it not? A. Yes, sir.

Q. Did you ever sell that stock in the hardware store? A. No, sir.

Q. You know what became of it?

A. The City Bank—he gave a chattel mortgage to the City Bank and they sold it and, I believe, it was $2,500.00.

(Testimony of Irene Arnold.)

Q. Was that after your chattel mortgage was made or before? A. Afterwards, I think.

Q. And you didn't object to the bank taking the chattel mortgage and the property?

A. No, by that time I had seen the building progressing and I knew any mortgage was covered by just the building and the [47] lots.

Q. The building was progressing steadily from the time you made your first loan or even quite a long time before that, up to the time you made the second?

A. Yes, because he had quite a few men helping him in the meantime and his apartments were progressing and getting more income.

Q. Could you tell the Court about what date the building was started—the work started on the building?

A. It started before—he had the frame up there before I knew him.

Q. The building was going up before you ever met them? A. Yes.

Q. I see, and you had known them about six months when you made the first loan?

A. I would say that.

Q. Now, this promissory note of December 22, 1950, that is the only note that you have now that is not paid, isn't it?

A. December 22, 1950, yes.

Q. $16,000.00? A. That is correct.

Q. And by keeping the second mortgage you considered the first mortgage paid and released?

(Testimony of Irene Arnold.)

A. That is right.

Mr. Dunn: May I ask Mrs. Arnold some questions? [48]

The Court: Yes.

Cross-Examination

By Mr. Dunn:

Q. Mrs. Arnold, I didn't understand—I didn't hear your answer to Mr. McCarrey's question concerning the efforts that were made by you to discover whether or not there were any liens against the property at the time you made these loans to the Kelseys. Now, speaking with respect to the second mortgage, the $16,000.00 mortgage, did you personally make any investigation of the records to see whether or not there were liens against the subject property?

A. I didn't because Mr. Kelsey said—this conversation took place in the office of Plummer and Arnell, and Mr. Kelsey, in the presence of Mr. Arnell said, "I will go downstairs where there was an insurance, guaranty insurance company, and have them look up the records," and he did do that.

Q. Is that a title insurance company that you are speaking of? A. Yes, sir.

Q. Now, do you know whether or not Mr. Kelsey got a report from the title insurance company?

A. Yes, he brought it up there before we completed this transaction. [49]

Q. And you say you saw it? A. Yes, sir.

(Testimony of Irene Arnold.)

Q. Did it show any liens?

A. It showed the Heinie Berger lien.

Q. And it showed no construction, just the mortgage lien of Heinie Berger?

A. That is right.

Q. Did it show one lien or two liens on behalf of Berger? A. It showed two liens.

Q. Those are mortgage liens?

A. Was at the time that I gave him the money to take up those liens.

Q. As far as your first loans are concerned, did you give the money to Mr. Kelsey and tell him to pay it off?

A. He was supposed to go right to the First National Bank and take it up.

Q. And you entrusted him to do that?

A. Yes, I did.

Q. And he did own the property?

A. That is right.

Mr. Bell: Did he say anything about the Ketchikan Spruce Mills having a lien on this property that furnished the material and was used upon the property, of $250.00 and the last was furnished November 26, 1949, did he mention that one to you? Do you remember whether he mentioned that one or not? [50]

A. I think he did and said he was going to pay that right off.

(Testimony of Irene Arnold.)

Further Cross-Examination

By Mr. Bell:

Q. Now, did he mention to you that Kincaid and King lien for materials in the sum of $674.00 which was furnished between August 24, 1950, and October 28, 1950, did he ever talk to you about that?

A. No, sir.

Q. Did he ever tell—did you ever know about a mortgage being made to D. H. Cuddy, Trustee, dated August 13, 1951, by R. W. Kelsey and Alice Roberts Kelsey, did he ever talk about that to you?

A. What was the name, please?

Q. Mortgage by Mr. and Mrs. Kelsey to D. H. Cuddy, Trustee, for Pat Ryan, Erma Schuler, V. W. Garrison and Alaskan Plumbing and Heating Co., Inc., of $4,131.00, did he ever discuss that with you?

A. No.

Mr. McCarrey: I object to any mortgage in 1951, we are talking about December, 1950.

Mr. Bell: I said ever talk to her about it?

Q. (By Mr. Bell): Now, there is a lien, according to the records, by Kenneth [51] W. Luse, between May, 1951 and July 28, 1951, for service and material furnished of $2,375.05, did you hear any of the Kelseys discuss or talk about that?

A. No, sir.

Q. And these other liens here you never discussed them with the Kelseys in any way?

(Testimony of Irene Arnold.)

A. No, sir, they weren't supposed to exist.

Q. Not at that date, Mrs. Arnold, I mean later as they accumulated from the work going on?

A. No.

Q. Now, when was it that you consented to the City Bank of Anchorage to take that chattel propperty for their mortgage, about what date was it?

A. I didn't really consent, they didn't ask me. They just went in and did it but I didn't attempt to do anything because I knew that by that time my mortgage was covered with what was there. So they just went in and the Marshal closed the doors, I guess, with their instructions, and they went in and made a public sale of it.

Q. And about when was that? About how long was that before the Kelseys left here?

A. Before they left?

Q. Yes.

A. Why, they had already gone. That is why they did.

Q. Oh, I see, they had gone when you did [52] that?

A. I didn't have the Marshal close the office.

Q. Were you the Trustee in bankruptcy at that time?

A. Not officially, I had just taken it over to try to protect my interests and do something for the tenants that were there, that had just paid him the first and last two months in advance, so they wouldn't lose their money.

(Testimony of Irene Arnold.)

Q. I mean, at the time that they sold this stuff, this hardware, you hadn't been appointed trustee?

A. No, sir, I was just——

Q. You were custodian?

A. I was just custodian and being responsible for the electric lights and $400.00 some odd dollars to Chugach Electric so they wouldn't cut the electricity off to the tenants that were in there.

Q. And how long did you act in that capacity?

A. I don't know, must have been six or seven months.

Q. Now, did you ever give an account to Mr. McCarrey of the rents you collected during that time? A. At all times—not on everything.

Q. That is all listed? A. Yes, sir.

Q. And that would be the six or seven months prior to the time you were appointed trustee?

A. That is correct.

Q. I think that is all. [53]

Mr. McCarrey: Mrs. Arnold, I would like to ask one question.

Redirect Examination

By Mr. McCarrey:

Q. Did you consider the $5,000.00 on the first mortgage mentioned with the second one or did you consider that it was paid?

A. No, it was mentioned.

Mr. McCarrey: Your Honor, I have a title search as of the 20th day of September, 1949, which might be of benefit to you.

(Testimony of Irene Arnold.)

Q. I would like to ask if that is the title search of that property? A. Yes.

Mr. McCarrey: We offer it in evidence, your Honor, as Exhibit No. 8 for whatever value it might be to the Court.

(Thereupon, the document above referred to was entered in evidence as Plaintiff's Exhibit 8.)

Mr. Dunn: I have another question I would like to ask, your Honor. [54]

Recross-Examination

By Mr. Dunn:

Q. Mrs. Arnold, you said that you didn't consider the first mortgage paid by the second mortgage but that you considered that the first mortgage mentioned with the second mortgage. Now, at the time of the execution of the second mortgage did you or did you not accept the promissory note for $16,000.00 and some odd dollars? A. Yes.

Q. Now, that $5,000.00 of that $16,000.00 and some odd dollars—the $5,000.00 was that represented by the previous promissory note given to you in 1949? A. I didn't understand the question.

Q. Was $5,000.00 of the $16,000.00 represented by the note given to you at the time of the execution of the second mortgage, the $5,000.00 that was represented by the first note that was executed at the time the Kelseys gave you the first mortgage? In

other words, did the $16,000.00 include the first $5,000.00? A. Correct, yes, sir.

* * *

(Thereupon, argument was had by the respective counsel.) [55]

United States of America,
Territory of Alaska—ss.

I, Iris L. Stafford, Official Reporter of the above-entitled Court, hereby certify:

That the foregoing is a full, true and correct transcript of the proceedings in the above-entitled matter taken by me in stenograph in open court at Anchorage, Alaska, on June 24, 1953, and thereafter transcribed by me.

/s/ IRIS L. STAFFORD.

[Endorsed]: Filed October 20, 1953. [56]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD ON APPEAL

I, M. E. S. Brunelle, Clerk of the above-entitled Court, do hereby certify that pursuant to the provisions of Rule 11(1) of the United States Court of Appeals for the Ninth Circuit, as amended, and pursuant to the provisions of Rule 75(g)(o) of the Federal Rules of Civil Procedure and pursuant to designation of counsel, I am transmitting herewith the original papers in my office dealing with the above-entitled action or proceeding, and including

specifically the complete record and file of such action, including the bill of exceptions setting forth all the testimony taken at the trial of the cause and all of the exhibits introduced by the respective parties, such record being the complete record of the cause pursuant to the said designation.

The papers herewith transmitted constitute the record on appeal from the judgment filed and entered in the above-entitled cause by the above-entitled Court on September 4, 1953, to the United States Court of Appeals at San Francisco, California.

/s/ M. E. S. BRUNELLE,
Clerk of the District Court for the Territory of Alaska, Third Division.

[Endorsed]: No. 14157. United States Court of Appeals for the Ninth Circuit. Victor F. Gothberg, an Individual, Doing Business as Gothberg Construction Company, Appellant, vs. Irene Arnold, Appellee; Sullens & Hoss, Inc., a Corporation, Appellant, vs. Irene Arnold, Appellee; United States of America, Appellant, vs. Irene Arnold, Appellee. Transcript of Record. Appeals from the District Court for the Territory of Alaska, Third Division.

Filed December 9, 1953.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14157

VICTOR F. GOTHBERG, et al.,

Appellants,

vs.

IRENE ARNOLD, et al.,

Appellees.

STATEMENT OF POINTS ON WHICH APPELLANT GOTHBERG INTENDS TO RELY ON APPEAL

Comes now defendant-appellant, Victor Gothberg, and states that he intends to rely on this appeal on the points hereinafter designated as follows:

1. That the trial court in this matter erred in its conclusions of law as follows:

(a) In setting up priority of various liens against the property by failing and refusing to prorate the various materialmen's and laborers' claims against the property by failing and refusing to pro laws of the Territory of Alaska.

(b) By allowing as claims prior to the claim of Victor Gothberg, mortgage of D. H. Cuddy, trustee, which mortgage was given as will appear from the records and files in this action for the purpose of securing pre-existing debts now shown to have been lien claims against the premises.

(c) For allowing the claim of Henry W. Cuffel on an attachment against the property now shown

by the record to have been a lienable item against the premises, and in fact, as will appear from the records and files of this action, such suit has not gone to judgment, and Henry W. Cuffel is not entitled to any lien against the premises as against labor and materialmen's liens, including the lien of Victor Gothberg.

(d) For allowing the claim of R. H. and Marie Vore as a claim against the property at all and in particular for allowing such claim as a lien prior to the lien of Victor Gothberg for the reason as will appear from the records and files of this action, such purported lien arose from and by reason of a Commissioner's Court suit commenced by the plaintiffs R. H. and Marie Vore, which judgment was not docketed in the District Court and never became a lien of any kind against the subject property.

(e) That the judgment entered by the court in this matter is erroneous in that it followed erroneous findings and conclusions of law of the court and in that all lien claims against the property arising out of labor and materialmen's liens should have been prorated as provided by law and not in the order of the filing of such liens for the reason that all of such liens, including the lien of the appellant Victor F. Gothberg should have been given priority over mortgages executed against the premises in that such liens were incurred in the alteration and repair of the premises, and by law take priority over mortgages. Appellant further intends to rely upon the point that the mortgage of D. H. Cuddy was a mort-

gage given to secure certain indebtedness owed by the defendants R. W. Kelsey and Alice Roberts Kelsey and was not a proper lien of any kind against the premises as against the lien claims of laborers and materialmen. Appellant Gothberg further intends to rely upon the fact that the judgment in question allows a priority to Henry W. Cuffel upon an attachment levied against the property in a suit which has not been reduced to judgment and that a priority is given to R. H. and Marie Vore on a judgment rendered in the Commissioner's Court, which judgment did not at any time become a lien against the real property which was the subject of the action of Victor F. Gothberg and which real property was sold to create the fund from which payment is here being made.

Appellant Victor F. Gothberg intends to rely upon the statement of facts used by the court in arriving at his findings of fact and conclusions of law together with the transcript of the hearing which took place on June 15 and on June 24 of 1953, and on the various complaints and other documents in the various files which were consolidated in connection with the cause here in question.

Appellant's objection here is not to the statement of facts used by the court, but to the application of the law by the court in attempting to determine the particular priorities of the parties in connection with this action, and appellant Gothberg claims that he is entitled to participate in the distribution pro rata with the other lien claimants for laborers and

materialmen's liens and prior to any distribution to the mortgagees or judgment creditors or attachment lienholders.

Dated at Anchorage, Alaska, this 8th day of February, 1954.

DAVIS, RENFREW & HUGHES,
Attorneys for Appellant,
Victor Gothberg;

By /s/ EDWARD V. DAVIS.

Receipt of copy acknowledged.

[Endorsed]: Filed February 11, 1954.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS UPON WHICH APPELLANT SULLENS & HOSS, INC., A CORPORATION, RELIES FOR REVERSAL ON APPEAL

1. The trial court erred in this matter in its Findings of Fact and Conclusions of Law, as follows:

a. In setting up priorities of various liens against the property and failing and refusing to prorate the various lien claims against the said property in question, as provided by the laws and decisions of the courts affecting the Territory of Alaska.

b. By allowing the claim of D. H. Cuddy, Trustee, for the reason that there was no just cause for this being set up as a prior lien of any kind.

c. By allowing the claim of R. H. and Marie Vore as a claim against the property at all; that the records and stipulation showed a state of facts that did not entitle them to a lien on the property at all, for the reason that a judgment in a commissioner's court suit, not docketed in the District Court, does not arise to the dignity of a lien of any kind against real estate.

2. That the Judgment entered by the Court in this matter is erroneous in that it followed erroneous findings of fact and conclusions of law of the Court, and in that all lien claims against the property, arising out of labor and material liens and the judgment lien of this Appellant, were prior to one of the mortgages of Irene Arnold as far as the lien was concerned, in that her mortgage was not properly executed to become a valid lien on the property at all.

3. That the lien of D. H. Cuddy, as Trustee, was given to secure the personal debts of R. W. Kelsey and Alice Roberts Kelsey, and was not a proper lien of any kind against the premises, insofar as it affected any of the other lien claimants, including the judgment lien claimant, Sullens & Hoss, Inc.

4. That the judgment rendered was not based upon any evidence in the case, over the objection of Sullens & Hoss, Inc., who asked permission of the Court to make proof on its case, and offered to prove its case, which would have, if permitted, established the fact that the property was originally purchased by R. W. Kelsey who had the property placed in the

name of his wife, Alice Roberts Kelsey, for the purpose of keeping his creditors from attaching it, and that the property was paid for completely by R. W. Kelsey and was built by his labor and was his property at all times; that he had complete control over it; that Alice Roberts Kelsey had no interest in the property other than being the wife of R. W. Kelsey; that said property became the homestead of R. W. Kelsey and, therefore Alice Roberts Kelsey had an interest therein to that extent only; that the lien filed by Sullens & Hoss, Inc., was never paid and released, but a similar amount of money was paid with the understanding that the lien would be released if the mortgage prepared and submitted by Sullens & Hoss, Inc., was executed; and that R. W. Kelsey and Alice Roberts Kelsey agreed to execute and deliver said mortgage and took it into their possession for execution and failed to return it to Sullens & Hoss, Inc., and were, therefore, notified that the amount of money that they had deposited in the law office of Bell & Sanders, would be applied on the judgment and the lien would not be released, and that no objection was made to the application of said funds on the judgment by either R. W. Kelsey or Alice Roberts Kelsey. All of the evidence was rejected, and at the same time Sullens & Hoss, Inc., objected to any judgment being rendered unless evidence was introduced to establish the right of judgment, it being noted that Sullens & Hoss, Inc., did not agree to the stipulation as filed. And since no evidence was introduced and no one offered to introduce evidence except Sullens & Hoss,

Inc., there was no foundation of a judgment in favor of anyone in this case except Sullens & Hoss, Inc.

5. The Court erred in admitting evidence at the hearing which was objected to by Sullens & Hoss, Inc.

6. The Court erred in granting Irene Arnold a prior lien for the sum of $5,000.00, based upon a mortgage that was not executed according to law; it was not signed by the opposite spouse and it was a mortgage purported to be upon the homestead property of R. W. Kelsey and Alice Roberts Kelsey, which mortgage was void upon its face and was insufficient to create a lien upon the particular real estate here.

a. The Court erred in allowing a lien to No. 2, commencing on page two of the Findings of Fact and Conclusions of Law, as follows:

a. The Court ererd in allowing a lien to No. 2, Ketchikan Spruce Mills, in the amount of $250.00 principal, plus interest of $56.50, and filing costs and attorney's fees;

b. The Court erred in allowing a lien to No. 3, Kincaid & King Construction Co., in the amount of $408.25, plus interest, costs and attorney's fees;

c. The Court erred in allowing a lien to No. 4, Heinie Berger, in the amount of $1,959.22, plus interest, and attorney's fees, for the reason that no proof was offered as to the balance due on said Note and Mortgage, if any;

d. The Court erred in allowing a lien to No. 5, Irene Arnold, in the amount of $10,344.81, plus in-

terest of $1,784.07, and attorney's fees, and making it a prior lien to all of the other liens named in the action.

e. The Court erred in rendering judgment for certain lien claimants Nos. 6 through 15, in said Findings of Fact and Conclusions of Law on Page three thereof, since no evidence was offered to support said liens.

8. The Court erred in failing and refusing to grant Sullens & Hoss, Inc., a lien based upon its judgment against the Defendant, which Judgment was duly entered of record in the District Court at Anchorage, Alaska, Third Judicial Division, in the sum of $1,676.89 principal, $125.70 interest, $230.00 attorney's fees, and $30.00 court costs, in Cause of Action No. 5504, which Judgment was rendered in the District Court on the 9th day of December, 1949, when it was alleged in the Cross-Complaint of Sullens & Hoss, Inc., that R. W. Kelsey and Alice Roberts Kelsey were then and there partners associated together in operating the business of Spenard Lumber Company and Mountain View Lumber Company, and that the said Thomas Kelsey referred to in the above-mentioned judgment is one and the same person as R. W. Kelsey.

9. The Court erred in overruling the objection of Sullens & Hoss, Inc., found on page 33 of the typewritten transcript of the Court below, as follows:

"A. Well, Mr. Kelsey said that Mr. Heinie Berger held a mortgage——

"Mr. Bell: Object to the statement as not responsive to the question. He asked what the instrument was.

"Q. Can you explain?

"The Court: I think you asked what the circumstances were in making something of that kind. Well, as I have ruled so many times, the objection that the answer is not responsive may be made only by the person conducting the examination * * *" (Emphasis Supplied.)

10. The Court erred in allowing a judgment lien in favor of Irene Arnold for the sum of $5,000.00, plus interest, costs and attorney's fees in one instance, and $10,344.81, plus interest and attorney's fees in another instance, for the reason that her testimony shows that she loaned altogether $16,609.51, $5,000.00 of which was not lienable at all because it was on a mortgage on homestead property without the signature of the opposite spouse, and she admitted in her examination that she had received while handling the property before she was elected Trustee, a sum of $18,000.00. (See typewritten transcript, Page 41.) This amount overpaid any loan she had made and she therefore had nothing whatsoever coming to her, and if she wrongfully spent or dissipated this money, she made no showing or justification of the spending of it, and is therefore barred from recovering anything whatsoever. She also admitted that she had not filed a final account with the Referee in Bankruptcy for the $6,000.00 that she collected after she became Trustee in Bankruptcy.

11. The Court erred in rendering Judgment in this action foreclosing the mortgages and liens without first procuring the disclaimer or consent of the Bankduptcy Court who had jurisdiction in the Bankruptcy suit filed by R. W. Kelsey and Alice Roberts Kelsey, and all actions taken by the District Court, in the Judgment here, are without jurisdiction until cleared through the Bankruptcy proceedings.

12. The Court further erred in allowing Irene Arnold priority over other liens when she admitted her loans were construction loans made for that purpose with full knowledge that the building was being constructed and that building material and labor were being expended thereon. Therefore, her lien, if any, is inferior to all other liens involved herein.

13. The Court further erred in not allowing Sullens & Hoss, Inc., a first and prior lien to all other liens, since its judgment was rendered on the 9th day of December, 1949, and was prior in date and prior in right to all other liens, since all other valid liens date subsequent to that time.

Dated at Anchorage, Alaska, this 9th day of February, 1954.

BELL & SANDERS,

By /s/ BAILEY E. BELL,
Attorneys for Appellant,
Sullens & Hoss, Inc.

Service of copy acknowledged.

[Endorsed]: Filed February 15, 1954.

No. 14188

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

BRIEF OF APPELLANTS, Bart McKenney and Marie McKenney, individually and as co-partners in McKenney Logging Company.

Appeals from the United States District Court for the District of Oregon.

THEODORE B. JENSEN,
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U. S. National Bank Bldg.,
Portland, Oregon,
Attorneys for Appellants, Bart McKenney and Marie McKenney.

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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE.

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Appeals from the United States District Court for the District of Oregon.

JURISDICTION

Plaintiff, Appellee, Buffelen Manufacturing Co., is a corporation incorporated and existing under the law of the State of California. Each of the defendants except Edward M. Buol and McKenney Logging Corporation

is a citizen of the State of Oregon. Defendant Edward M. Buol is a citizen of the State of Washington and defendant McKenney Logging Corporation is a corporation incorporated and existing under the laws of the State of Washington. The matter in controversy exceeds, exclusive of interest and costs the sum of $3,000.00 (Complaint, Paragraph I, Tr. 3). Jurisdiction of the District Court existed by virtue of the amount in controversy and the diverse citizenship (Title 28, Sec. 1332, U.S.C.). This Court has jurisdiction under Sec. 1291, Title 28 U.S.C.

STATEMENT OF THE CASE

The District Court granted certain injunctive relief and awarded the following sums as damages to Appellee against the Appellants:

1. $168,000 against the Appellants, defendants below, Bart McKenney, Marie McKenney, Einar Glaser and Dorothy Glaser, jointly and severally;
2. $268,000 against the Appellant McKenney Logging Corporation.

$118,000 thereof was for alleged loss of profits in the operation of Appellee's mill (herein referred to as Batterson Mill). $50,000 thereof was for alleged cutting of logs from the lands involved herein, and the additional $100,000 awarded against the corporate defendant, McKenney Logging Corporation was for trespass in such cutting of logs.

The Appellants, McKenney and Glaser, operated as partners under the name of McKenney Logging Company until this controversy arose.

The Appellants, Bart McKenney and Marie McKenney (who will at times herein be referred to as McKenneys) have appealed separately from the other Appellants, Glasers and the McKenney Logging Corporation, and this is the brief of the Appellants, McKenneys.

This is an action for breach of a contract concerning the cutting and sale of logs from lands in Tillamook County, Oregon and the supplying of logs to a small mill (capacity 45,000 feet per shift) which mill is located on such lands at a point called Batterson. The mill is referred to throughout the case as the Batterson mill. The contract is dated January 8, 1948 and is between the Appellee-plaintiff below, Buffelen Manufacturing Co., assignee of Buffelen Lumber & Manufacturing Co. (Tr. 151) as purchaser of the logs and Bart McKenney and Marie McKenney and Einar Glaser and Dorothy Glaser, partners doing business under the name McKenney Logging Company of the defendants below and Appellants here as loggers and sellers of the logs. That contract is plaintiff's Exhibit 1 in the case and will be at times hereinafter so designated for convenience. It is set out in full at pages 125 to 146 in transcript of record. A supplemental agreement thereto is dated May 10, 1948 (Tr. 146-150). The contract and the supplement thereto involves large timber holdings, 110 to 130 million feet in the area known in Oregon as the Tillamook Burn, which Burn comprises more than one-half of Tillamook

County in the Northwestern part of Oregon on the Pacific Coast. (The name is due to a disastrous fire which occurred in 1935.)

The controversy herein arose in September, 1951, when the partnership, McKenney Logging COMPANY, attempted to transfer their rights under the contract (Exhibit 1) to McKenney Logging CORPORATION, which Corporation had been then organized under the laws of the State of Washington by the defendants Edward M. Buol and J. B. Carr for the purpose of acquiring such rights. The contract contains a provision that the contract cannot be assigned without written consent of both parties (Tr. 134). Appellee, Buffelen Manufacturing Company claims that it did not give its consent to the attempted assignment and the District Court found that written consent had not been given (Finding IX, Tr. 88). This action is also against the McKenney Logging Corporation for trespassing and wrongfully cutting timber, for inducing breach of the contract, Exhibit 1, and for damages arising therefrom.

The contract, Exhibit 1, among other things states that the partners in the contract designated as Loggers had for the past several years been engaged in acquiring timber and timber lands and logging contracts in Tillamook County, Oregon, and adjacent territory and had been actively engaged in the logging business in such district; and the Appellee, Buffelen Manufacturing Company (designated in the contract as the "Lumber Company") and the Appellant, McKenney Logging Company, Appellants (designated in the contract as "Log-

gers"), had during such time had under oral or written contracts the first and exclusive option to purchase all of the entire output of the partners, McKenney Logging Company and had "generally speaking" purchased all of said output (Tr. 126) (such prior written contract was dated May 22, 1946, being rejected pre-trial Exhibit 24 herein, Tr. 556-563 and Tr. 281). The McKenney Logging Company (the partners) had in carrying out their operations by January 8, 1948 (date of Exhibit 1) acquired timber and timber lands aggregating some 20 sections which included the tracts owned or controlled by one Scritsmier & Co. (Tr. 311). In addition thereto, the McKenney Logging Company (the partners) had made a contract with one Belding Logging Company for the logging of a certain tract of green timber in the same area which green timber includes Sec. 6, so mentioned and discussed at various times throughout the testimony in this case. The Belding contract covered about two sections of land (Tr. 311). The Appellee, Buffelen Manufacturing Company (at times herein called Buffelen), advanced sums aggregating $130,000.00 for the acquisition of timber lands and timber rights covered by the Belding contract. All of such timber so acquired had been under contract to McKenney Logging Company. When Buffelen advanced sums aggregating $130,000.00 to $140,000.00 Buffelen took the timber and lands then under contract from Belding Logging Company to McKenney Logging Company in its own name, Buffelen (Tr. 282-284; Schedule A attached to Exhibit 1, and Schedule B attached to Exhibit 1, Tr. 142, 143).

On Schedule C attached to Exhibit 1 is a list of the timber lands and cutting rights standing in the name of McKenney Logging Company, the partnership (Tr. 145). The above mentioned supplemental agreement between Buffelen Lumber & Manufacturing Company and the McKenney Logging Company (partnership), dated May 10, 1948, Plaintiff's Exhibit 2 (Tr. 146-147), refers to the advances made for the purchase of the said Belding, Scritsmier and Yellow Fir Company timber and lands and the method of repayment ($5.00 per M) on all merchantable logs taken from the lands owned or controlled by either the Lumber Company (Appellee) or the Loggers (partnership) until all of the money advanced to the Loggers, McKenney Logging Company (partnership) had been repaid; and said supplemental agreement (Exhibit 2) receipts for an additional advance of $24,000 for use by the Loggers (partnership), in the acquisition of the "Piatt" contract for cutting rights from the State of Oregon. The supplemental agreement gave Buffelen Manufacturing Company (Appellee) first right and option to purchase all of the logs produced from the timber under this "Piatt" contract acquired by the partnership at the market price or mill-pond price the same as provided under the contract of January 8, 1948, Exhibit 1. The $24,000 would be repaid by the Lumber Company (Appellee), deducting $10 per thousand feet, log scale, from the market price or mill-pond price as determined under the Agreement between Buffelen (Appellee) and McKenney Logging Company (partnership) dated January 8, 1948 (Exhibit 1 herein). Buffelen Manufacturing Company, Appellee, and Mc-

Kenney Logging Company (partnership) operated under the contract and supplement (Exhibit 1 and Exhibit 2) until about September 5, 1951, when the McKenney Logging Corporation, the Washington Corporation, one of the Defendants-Appellants herein, organized by the defendants herein, Edward M. Buol and J. B. Carr, as above stated, obtained possession and control of these large holdings by a plan engineered by one E. R. Errion, a real estate broker (Tr. 41). The payment to the partnership was evidenced solely by two notes for $575,000 each and a mortgage on all of the above mentioned holdings. The approximate value of such holdings at that time was $1,150,000 (Tr. 44-46, Cross-complaint filed by Appellant-Defendants Bart McKenney and Marie McKenney). Such Cross-complaint was dismissed by the District Court on jurisdictional grounds.

The Plaintiff-Appellee, Buffelen Manufacturing Company admitted during the trial in the District Court (Tr. 286, 287) performance by the company, the partnership, of all conditions of the contract except in only two respects. 1. In attempting to assign the contract without Buffelen's consent and 2. in failing to give Buffelen the first option to buy logs produced from the properties.

It is also admitted in the Pre-trial Order as agreed fact IV, "By June of 1950, defendants McKenney and Glaser" (the partnership) "had repaid plaintiff" (Buffelen) "all loans and advances made to them by it, including plaintiff's loans and advances for the purchase of the timber lands and cutting rights covered by the contract

which is identified as plaintiff's Exhibit 1, together with interest thereon" (Tr. 12). The partnership had paid the taxes on all of the land and timber rights, including the above mentioned Belding tract which is in the name of Buffelen the Appellant (Tr. 285). The outlay by Buffelen for the purchase of the Belding tract above mentioned was $3.50 per thousand on 32,000,000 feet of green timber. The McKenney Logging Company, prior to such advance by Buffelen, had this green timber under contract with Belden, and owned and/or controlled about 200,000,000 feet of dead timber in this large area (Tr. 282) which is generally known as the Tillamook Burn area.

Plaintiff's Exhibit 16 (Tr. 391) being a Recap. of footage bought by Buffelen from the McKenney Logging Company (partnership) under the contract, Exhibit 1, prior to the controversy involved herein further indicates the size of their logging operation and shows that Buffelen purchased 55,546,171 feet of logs and paid to the partnership $3,490,991.88 therefor. It is uncontroverted that Buffelen paid the market price for such logs with no deductions for stumpage other than the amounts deducted for repayment of the above mentioned advances of $120,000 and $24,000. After the advances had been repaid to Buffelen and all advances had been repaid before this controversy and trial (Tr. 285, 286), Buffelen paid the full market price (which market price was established as hereinbelow stated) for the logs to the partnership in the same manner as if Buffelen had purchased them from third parties in the open market. Logs that Buffelen did not buy were then sold in the open market at the same prices which Buffelen would have been re-

quired to pay if Buffelen had purchased such logs, and it is uncontroverted that the entire proceeds of such sales belonged to and were kept by the partners, the Loggers.

Raft 44M discussed frequently during the trial of the case, first discussed at page 182, transcript of record, contained logs which had been cut from lands listed on Schedule A of Exhibit 1, which lands then stood and still stand of record in the name of Buffelen Manufacturing Company. Raft 44M (M is McKenney Log Brand) contained peeler logs (Tr. 291). Buffelen's manager Holm in part testified, "To my knowledge it was the first raft of green logs coming out of the Tillamook Yellow Fir area" (Tr. 182). The raft was sold to purchaser other than Buffelen. It was scaled September 4, 1951, about the time this controversy arose (Tr. 306). A witness for the plaintiff, Roy Gould, testified that stumpage on Yellow Fir, Green Fir cut from the land standing in the name of Buffelen, particularly in Section 6 (see Schedule A, Exhibit 1. Section 6 is mentioned in the testimony first at Tr. 223) had a market price of $25 per M. The District Court among other things found that the McKenney Logging Corporation who had obtained control of the partnership properties about September 5, 1951, had cut 2,000,000 feet of such stumpage of the value of $25 per thousand feet (Finding of Fact X, Tr. 88) and awarded judgment against the partners for $50,000 and against the Corporation for $150,000 (treble damages under Oregon Statute). Yet, on October 3, 1951, Buffelen Manufacturing Company tendered its check payable to the partnership for $19,379.86 for Raft 46M which had been sold to a purchaser other

than Buffelen and which also contained logs cut from above mentioned Sec. 6 for which the full market price was included in such $19,379.86 tendered (Plaintiff's Exhibit 4, Tr. 154-156). The check so tendered was, of course, returned to Buffelen. So that the partnership has been held by the Court in effect not to be the owner of the stumpage if it failed to offer the logs to Buffelen, but entitled to full payment for the stumpage in the same manner as if the timber stood in the name of the partnership if the logs cut therefrom were tendered to Buffelen although Buffelen refused to purchase them and the logs so cut were sold to others than Buffelen. Likewise, if Buffelen bought the logs so cut Buffelen would pay the full market price to the partnership which, of course, includes the $25 per thousand for stumpage which $25 price was set by witness Gould as above stated.

Further, the District Court allowed $118,000 damages to Buffelen Manufacturing Company against the partnership for loss of profits in the operation of the Batterson mill resulting from the failure of the partnership to offer the logs to Buffelen. This matter of loss of profits will be discussed hereinbelow in detail, but in passing it is important to mention here that under the judgment allowed of $50,000 (the above mentioned 2,000,000 feet at $25 per M.) for logs cut from Section 6 and not offered to Buffelen the partnership is assessed damages for logs which, if they had offered them to Buffelen and Bueffelen had refused to purchase them the partners would have been entitled to sell them elsewhere and been entitled to the $50,000, and if Buffelen

had purchased them, the partners would still have been entitled to the $50,000 (Plaintiff's Exhibit 4, Tr. 154-156). The District Court concluded that the contract of January 8, 1948, as supplemented by agreement May 10, 1948, above mentioned, Exhibit 1, did not terminate upon repayment of the loan and advances made thereunder (Conclusion of Law VII, Tr. 92) and permanently restrained the partners from breaching the contract and declared the purported sale to the McKenney Logging Corporation (above mentioned) cancelled and void. So that the contract was at all times in effect and remained in effect by the District Court Judgment and Decree herein (Tr. 95, 96).

Also, the very logs for which the partners are charged $50,000 in damages by the District Court constitute the basis for part of the $118,000 damages charged by the District Court against the partners for loss of profits in the operation of the mill at Batterson for failure of the partners to tender the same logs to the Batterson mill.

The contract (Exhibit 1) states in part that, "After all advances on the Logger's notes or open account have been paid, the Loggers shall pay to the Lumber Company, as stumpage, for all timber removed from the Lumber Company's lands at the actual cost to the Lumber Company of the average of the Lumber Company's timber holdings in that area. This cost shall consist of the amount actually paid by the Lumber Company for such timber, together with interest thereon at the rate of four per cent per annum at the time of such purchase, as well as all taxes, insurance, if any, and any and all other expenses to which the Lumber Company has been

put in acquiring such timber holdings . . ." As above stated, it is admitted in the pre-trial order that the Loggers, the McKenney Logging Company, the partnership had repaid the Lumber Company, Buffelen, all of its advances, including Buffelen's advances for purchase of timber lands and cutting rights covered by the contract (Exhibit 1, Paragraph IV, Pre-trial Order, Agreed Facts, Tr. 16).

The contract also states that the primary purpose of the Lumber Company in the purchase of the timber tracts, Belding, Scritsmier and Yellow Fir Company, above mentioned, was to keep its mill at Tacoma and the mill which it was then building, the Batterson mill, in logs and with no desire on its part to make a profit out of the logging end of its business, either during the logging operations by the Logger or at the conclusion of its operations in the area. (Tr. 129, Exhibit 1).

Buffelen had no facilities for cutting veneer at the Batterson mill and therefore had no need for peeler logs (Tr. 337). Buffelen, of course, had not purchased all of the logs produced from the lands covered by the contract. Buffelen had virtually stopped buying logs under the contract for processing at Tacoma long before this controversy arose (Exhibit 16, Tr. 391). The logs not purchased by Buffelen, some less than half, were sold by the partnership to various buyers on the Columbia River (Tr. 300). The average daily production of logs by the partnership ran from 150,000 to 250,000 feet (Tr. 301). The logs had a market. All logs not purchased by Buffelen were sold freely at the market price at As-

toria, Oregon and elsewhere on the Columbia and Willamette Rivers. Astoria, Oregon is only 50 miles from the Batterson mill (Tr. 302). There was a market price for logs at the Batterson mill (Tr. 391, Plaintiff's Exhibit 16).

About the time this controversy arose, one Roy Gould (above mentioned), operator of the Diamond Lumber Company, had an arrangement with Buffelen in anticipation of the purchase of the Batterson mill by Gould and under such arrangement gave the operating instructions in connection with the mill during October and November, 1951 (Tr. 219, 231). Gould's compensation for such operation during October and November, 1951, was whatever profit he could make out of it (Tr. 235). The agreed purchase price to Gould was $250,000 (Tr. 237). Mr. Andrew Koerner, of Koerner, Young, McColloch & Dezendorf, Attorneys, Portland, Oregon, and attorneys and counsel for Plaintiff-Appellee in the instant case, represented Gould in this proposed transaction (Tr. 237, 381, 384). Gould testified for plaintiff that $8,000 to $10,000 a month would be an expected profit from the operation of the mill (Tr. 220). *Gould was to assume the losses,* if there were any losses sustained for his period of operating under the above arrangement (Tr. 255). The result of the operation under Gould for October and November of 1951 was a substantial loss (Tr. 221). It is upon Gould's testimony as an expert and Exhibits 19a, b, c and Exhibit 22 (such exhibits are discussed hereinbelow) with Buffelen, that Appellee relies to sustain an award by the District Court of $118,000 damages against the partners, Appellants

for loss of profits in the operation of the Batterson mill from the time this controversy arose, about September 5, 1951, until the second hearing of this case December 5 and 6, 1952.

A circumstance that may be mentioned here is that this case was tried in the District Court on January 14, and 15, and 16, 1952, and on January 16, 1952, the trial judge took the case under advisement. The Appellants, two of the defendants below, Bart McKenney and his wife Marie McKenney, thereafter concluded to change attorneys. All of the Appellants, defendants below, had until then been represented by the same attorneys, W. J. Prendergast, Jr. and Leo Levenson. In the latter part of February or the first part of March, 1952, the Appellant Bart McKenney and his wife brought the case to Mr. Theodore B. Jensen of his present counsel. Mr. Jensen is related to Marie McKenney, wife of Bart McKenney (Tr. 438). One of the disputed questions at the trial of January 14-16, 1952 (hereinafter referred to as first hearing) was whether or not the Appellant McKenney Logging Corporation had knowledge of the contract which is the subject of this litigation prior to September 21, 1951. On January 15, 1952, Bart McKenney testified when produced as a witness on behalf of plaintiff, to the question asked counsel for Plaintiff-Appellee—"Did you tell any representative of McKenney Logging Corporation prior to the attempted sale of the existence of the January 8, 1948 contract?" Answered, "No." And to a further question "You say you did not?" Answered, "I didn't" (Tr. 445). On March 31, 1952, counsel for Appellee, Buffelen, orally moved to re-open the case and on

the same day present counsel for McKenneys moved to be substituted as attorneys for McKenneys. The latter motion was based upon an affidavit that McKenneys had a good cause of suit against the other defendants (Tr. 32). The trial court took the motion under advisement and on June 23, 1952, made an order granting both motions (Tr. 34).

On the second hearing December 5, 1952, Bart McKenney testified that the contract had been discussed at conferences when the defendant J. B. Carr, who became and is an officer in the defendant McKenney Logging Corporation, was present (Tr. 429, 434, 435). The trial court found that the "McKenney Logging Corporation was charged with full knowledge of plaintiffs interests and rights under the contract above set out" (Tr. 72 and Conclusions of Law IV, Tr. 91).

On December 1, 1952, plaintiff filed a supplemental complaint alleging an increase in damages of $200,000 (Tr. 66) over the $100,000 general and the $300,000 punitive damages it had asked for in its original complaint (Tr. 405).

A supplemental pre-trial order (Tr. 66) was made December 5, 1952, wherein it was agreed that the original pre-trial order entered herein on January 14, 1952 as supplemented by such order should form the basis for the re-trial of this action. Further, the supplementary order provides that the evidence to be offered on the re-trial should be directed to issues of fact NUMBERED IN THE ORIGINAL so that, except for the increase of the alleged amount of damages, no changes in the original

pre-trial order occurred because of the amended answer and the cross-complaint filed by McKenney and the answers thereto by the other defendants as heretofor set forth.

LOSS OF PROFITS

Plaintiff has attempted to show a profitable operation of the Batterson mill for a period from April 1, 1948 through June 30, 1951 by its Exhibits 19a, 19b and 19c.

On Exhibit 19a covering a period for 12 months ended June 30, 1949 appears a book loss for the period of $6,132.62. On Exhibit 19b covering a period for 12 months ended June 30, 1950 appears a book profit for the period of $113,309.75. On Exhibit 19c covering a period for 12 months ended June 30, 1951, appears a book profit for the period of $75,743.78. Plaintiff's witness Samuel R. Miles, Assistant Secretary-Treasurer and Accountant of Buffelen Manufacturing Company testified that if you divide $113,309.75 by 12 the result would be about $9,000 a month, and if you divide $75,743.78 by 12 the result would be about $6,000 a month. When he was asked what were the market conditions during that period he stated that was out of his line (Tr. 203).

Plaintiff-Appellee also produced Exhibit No. 22—as Batterson Mill Profit and Loss Statement for fiscal year July 1, 1951-June 30, 1952 and for the period July 1, 1952 through October 31, 1952. The second hearing of this case was held on December 5th and 6th, 1952 as above stated.

SPECIFICATION OF ERROR NO. I

The Court erred in finding that plaintiff sustained damages in the amount of $118,000.00 for loss of profit of the operation of its mill at Batterson by reason of the attempted sale by defendants McKenney and Glaser of their interest in the properties and rights covered by the contract, plaintiff's Exhibit I (Finding pp. 88-89).

Said finding is clearly erroneous, in that it is not supported by substantial evidence since the only evidence in the case to support such finding is:

1. Testimony of plaintiff's witness Roy Gould (Tr. 218-24). Consists of surmise and conjecture that mill could make profits although said witness Gould's operation thereof resulted in a substantial loss.

2. Plaintiff's Exhibits 19a, 19b, and 19c, Tabulations headed Batterson Cost Reports for 12 months ended June 30, 1949, 1950 and 1951 respectively (Tr. 200, 201, 202, set out in Appendix A., pp. 47-52 of this brief), with the monthly cost reports for all of each 12 months period omitted therefrom except the first thereof, since such monthly reports are all similar, and the first of each 12 month period is believed by counsel sufficient for this illustrative purpose. Such Exhibits are wholly insufficient as substantive evidence for several reasons: one, there is no data thereon whereby it can be determined the basis upon which lumber was transfered from yard to yard of plaintiff in

order to set up the Book Profit or Book Loss stated on the exhibits.

3. Plaintiff's Exhibit No. 22—headed Batterson Profit and Loss Statement Fiscal Year July 1, 1951-June 30, 1952, and Batterson Mill Profit and Loss Statement July 1, 1952 through October 31, 1952,—follows page 479, transcript of record, offered page 475, admitted page 479. Exhibit 22 is wholly without evidentiary value until there is first sufficient substantial evidence by way of #1 and #2 immediately hereinabove. Further exhibit 22 is too vague and indefinite to serve the purpose intended.

4. Testimony of plaintiff's witness Samuel R. Miles, first hearing in connection with introduction of Exhibits 19a, b, and c (Tr. 200-205). Second hearing in connection with Exhibit 22 (Tr. 475-484). This witness added nothing to 1, 2 and 3, immediately hereinabove or otherwise.

Points and Authorities

Before a contemplated profit can be recovered the proof must consist of actual facts from which a reasonably accurate conclusion regarding the amount thereof can be logically and rationally drawn.

Randles v. Nickum & Kelly Sand & Gravel Co., 169 Or. 284, 127 P. (2d) 347.

National School Studios v. Superior School Photo Service, 40 Wash. (2d) 263, 242 P. (2d) 756, 762.

Gilmartin v. Stevens Inv. Co., Vol. 143, No. 9, Wash. Advance Sheets, 267, 261 P. (2d) 73.
United States v. Thornburg, CCA 8, 111 F. (2d) 278 at 280.

Argument

The testimony of the above mentioned witness Roy Gould, called by the plaintiff, shows that he, as the Diamond Lumber Co., had made an arrangement with the plaintiff, Buffelen, whereby he was to give the operating instructions for the Batterson mill during October and November, 1951. He had already looked over the mill in anticipation of buying it. The agreed price was $250,000. He believed that if he would have had reasonably good logs to operate on during October and November, 1951 he could have shown a substantial profit. He stated that such anticipated profit for a monthly operation would be from $8,000 to $10,000 a month, and that the output on a one shift basis would be 50,000 feet daily and on a two-shift basis about 40,000 daily additional (Tr. 220).

Gould during such operation had the status of an owner, for he was responsible for the losses and would have taken the gain if there had been any (Tr. 219, 220, 221). Under Gould's operation *there was a substantial loss* (Tr. 221). Gould attributed such loss mainly to lack of logs. To the question by plaintiff's counsel, "By buying logs on the open market down there were you able to keep enough supply to operate continuously?", Gould replied, "No, we were out of logs at times."

Such testimony was considered in *Randles v. Nickum & Kelly Sand Co.,* 169 Or. 284, a case where plaintiffs recovered a judgment in the trial court for damages, both general and special, arising out of a conversion of a stock of lumber. Plaintiffs were denied access by the defendants to a warehouse where the lumber was stored and claimed damages for loss of profits because the unavailability of the lumber to them deprived plaintiffs of profits which they would have made in construction of homes which they had contracted to build for others. The Oregon Supreme Court in rejecting the claim for loss of profits said (in part):

> "First, the evidence that profits would have been made had the houses been completed is a mere estimate of the plaintiffs. They contracted to build the houses at an agreed price, and they testified that the cost of construction in each instance would have been about $800 less than the contract price, hence a profit of $800 on each house. This, they said, was the normal profit. They produced no supporting data from which the jury could have ascertained whether a profit of $800 or in any other amount would have been realized. There was no testimony that the plaintiffs had made a profit under similar contracts" p. 287, supra.

The Oregon Supreme Court quoted from the testimony as follows (similar to the testimony given by plaintiff's witness Gould in the instant case), p. 288, supra:

> "One of the plaintiffs testified 'Q. I assume that all jobs you have taken have been profitable?
> A. Oh, no, sir.
> Q. And sometimes you make losses?
> A. Sure.
> Q. Of course, you can't tell that until you have completed your job, isn't that right?

A. Generally not from the beginning.
Q. I mean you take a loss job?
A. I have done it.' "

And the Oregon Supreme Court observed in that case that to sanction the recovery for damages for which there is no firmer foundation than was provided in *Randles v. Nickum & Kelly Sand & Gravel Co.* would be practically to remove all the safeguards which the law has wisely thrown around claims of this character. The court said that absolute certainty that there would have been profits, or certainty as to their amount, is, of course, not required. But that it is essential that the plaintiffs' present such evidence as might be reasonably expected to be available under the circumstances.

The Court cited in this connection Restatement, Torts, 580, Sec. 912, and 15 Am. Jur., Damages, 574, Sec. 157, and quoted from Sec. 157 as follows:

> "The proof must pass the realm of conjecture, speculation or opinion founded on facts, and must consist of actual facts from which a reasonably accurate conclusion regarding the cause and the amount of the loss can be logically and rationally drawn."

The Washington Supreme Court in discussing the same question with respect to proof stated in *Gilmartin v. Stevens Inv. Co.* (Sept. 1953), Vol. 143, Wash. Advance Sheets, No. 9, p. 267 at 271, 261 P. (2d) 73, 76, as follows:

> "What is reasonable certainty depends largely on the extent to which the particular damage in issue is susceptible of accurate proof. When, for example, a plaintiff in attempting to prove loss of profit, fails to produce available records relevant to that ques-

> tion, he fails to meet the standard of reasonable certainty. *National Schools Studios, Inc. v. Superior School Photo Service, Inc.,* 40 Wash. (2d) 263, 242 P. (2d) 756."

Although Appellant, Buffelen, may suggest some claim that Gould was testifying for Buffelen as an expert, his status is much the same as the plaintiffs in *Randles v. Nickum & Kelly Sand & Gravel Co.,* p. 288 of 169 Or. Reports, for Witness George Holm, Division manager, Raw Materials of Buffelen, testified on cross-examination that Gould was to assume any losses, if there were any losses during his operation of the mill, October and November, 1951.

In *National School Studios v. Superior School Photo Studios,* 40 Wash. (2d) 263, 242 P. (2d) 756, where the employer sued a former employee for damages for breach of restrictive covenant not to compete after termination of employment, the trial court had stated on the point of loss of profits in a memorandum opinion:

> "Plaintiff is seeking both damages and an injunction. The plaintiff has shown a very substantial loss in gross revenues and customers. Plaintiff declined to show its costs, and has not proved any reliable basis for determining the amount of its loss, if any, in net profit. Consequently, plaintiff is not entitled to recover damages."

The Washington Supreme Court said that the trial court was correct in denying Plaintiff-Appellant judgment for damages because of inadequacy of its proof. The court said (in part):

> "The burden was upon appellant to prove with reasonable certainty its loss of profits caused by respondents' acts. The bare, oral statement by appel-

> lant's president that it made ten per cent profit on the dollar volume of the business obtained by Lien is a mere conclusion. It does not constitute the reasonable certainty which is required under the circumstances."

The Washington Supreme Court observed that it was common knowledge that such a corporation as Appellant which was doing business in nearly every state in the union must keep detailed books of account from which its net income could be ascertained. And that it would have been a simple matter to have computed such income with respect to the portion of its business obtained from its former employee, Lien. That the Appellant had displayed no difficulty in ascertaining from its ledger sheets the gross dollar volume of business obtained by Lien for the two years prior to his leaving its employ. The Court concluded:

> "In the absence of reasonably certain proof as to what appellant's net profit would have been had it continued to enjoy this business, there is no competent evidence upon which a judgment can be based. The burden was upon appellant to furnish such proof and this it failed to do."

In the instant case, Plaintiff-Appellee Buffelen sought to prove loss of profits in the operation of the Batterson Mill from September 1, 1951 to the time of the second hearing herein, December 5 and 6, 1952, through its Exhibit No. 22. (Received in evidence Tr. 479. The Exhibit is set out in full at Tr. 480.)

Such exhibit consists of a document entitled "BATTERSON MILL PROFIT AND LOSS STATEMENT Fiscal Year July 1, 1951 - June 30, 1952" and

"Batterson Mill Profit and Loss Statement July 1, 1952 through October 31, 1952"

From an examination thereof it will be disclosed that it contains 9 columns of figures, the 9th of which is entitled Profit or Loss and partly for the purpose of emphasizing the inadequacy of and the indefinitness of the exhibit, we are here setting out the following portions of such statements (Tr. 480):

"1951	"Profit or Loss	
July	7,609.45*	"Vac. & Closed
Aug.	8,299.54*	Closed
Sept.	8,610.00*	Closed
Oct.	6,084.59*)	Operated by Gould
Nov.	8,076.27)	his figures not
Dec.	3,425.74*	included
1952	*	
Jan.	3,302.89*	Closed
Feb.	2,733.20*	Closed
Mar.	23,657.95*	Closed
Apr.	7,890.96*	One Shift
May	4,786.81*	Strike
June"	1,642.76	One Shift"
	$66,682.10	

Average Monthly Loss 5,556.84"
"*Figures in red."

"1952	"Profit or Loss
July	570.05*
August	7,414.86
Sept.	9,189.22
Oct."	2,412.24*
	$13,621.79

Average Profit per month $3,405.45"
"*Figures in red."

As part of the objection made by counsel to this exhibit when it was offered in evidence is pertinent here we wish to quote the following part of such objection (Tr. 476):

> "It in and of itself establishes no damages because of the fact that if the contract is taken as being in existence it limits the amount of logs to be furnished to this mill at sufficient logs for a one-shift-per-day basis."

Witness William O. Gansberg, who was sent down to the Batterson Mill to procure suitable logs for the operation of the mill at Batterson by Mr. Holm, of Buffelen, testified (in part), "Well, we were able to get enough logs to run on a one-shift basis" (Tr. 469).

And in response to the question on cross-examination "How many months did the mill operate since January of this year?" (Tr. 470). (This testimony was taken at the second hearing, December 5th and 6th, 1952.), the witness Gansberg replied:

> "I believe the operation started in April and it was down for a time because of the strike, and then down for a time in October because of lack of logs due to no logs being put in because the loggers were shut down.
> Q. They were shut down on account of fire weather.
> A. That is right, yes" (Tr. 471).

This Exhibit 22 must remain out of the case until the Plaintiff-Appellee has first satisfactorily proved that the Batterson Mill made profits before September, 1951, the time when this controversy arose. Counsel for Appellee recognized this situation in the statements made to the Court at the time Exhibits 19a, 19b, and 19c, were offered in evidence by Appellee (Tr. 202). We submit

that to award $118,000 loss of profits on Exhibit 22 is to base the finding in support thereof upon conjecture and speculation.

The Appellee attempted to prove that the Batterson Mill so made profits by such exhibits 19a, b, and c. (See appendix this brief). But by inspection of such exhibits, all of which were admitted as SUBSTANTIVE EVIDENCE and constitute the only factual data in the case, on this point, it will be observed that the documents are entitled BATTERSON COST REPORT and the figures relied upon by Plaintiff-Appellee to prove losses and profits are designated on the face of the document as BOOK LOSS AND BOOK PROFIT OR LOSS.

While Exhibit 19a, which covers the year for the 12 months ended June 30, 1949, has a designation "Value Realized" thereon and it appears on the face thereof that the Book Loss was $6,132.62, it should be noted that exhibits 19b and 19c have no such designation or any other data whatever by which it can be determined or even be presumed that the disposition of the lumber manufactured in the Batterson Mill was anything more than interdepartmental transfers from the Batterson Mill to the Tacoma plant of Buffelen Manufacturing Company.

Referring to the figures on Exhibit 19b more specifically it would appear that 18,105,662 feet of lumber had been manufactured during the year ended June 30, 1950 at a cost of $46.92 per M. of which 3,850,380 feet thereof had been sold to others at $32.55 per thousand at a loss of $14.37, (Cost $46.92, Selling price $32.55);

and 9,402 feet thereof had been transferred to Hardwood-Tacoma at $160 per M., a book profit of $113.08 per M., and 661,973.55 feet thereof had been transferred to Door Factory-Tacoma at $79.23 per M., a book profit of $32.31 per M. And 168,652.78 feet had been transferred to Sawmill at Tacoma at $28.96 per M., a book loss of $17.96 per M. And 6,673.80 feet is designated P.M. #3 transferred at $100 per M., a book profit of $53.08 per M.

BUT WHERE IS THE PROOF or data to show that such transfers were made at the market price. There is nothing to show how the price was arrived at in making such transfers. Taking the language of the Exhibits themselves, the exhibits are simply Cost Reports with some additional data as to transfer of lumber from yard to yard. The reports say Book Profit or Book Loss. Exhibit 19c is likewise of the same purport. The trial court inquired of counsel for Buffelen 9 (Tr. 204):

> "I understand, but then aren't the books here?
>
> Mr. Dezendorf: The books are not here, no.
>
> The Court: I understood you to say before that they were here.
>
> Mr. Dezendorf: But the monthly records that support the figures that we have are attached to those few exhibits. The mill was not operating in July or August of 1951, is the answer to his question."

But the "attached" "monthly records" are simply the annual statements divided in 12 parts and each of them contain the same designations with respect to transfer to Tacoma and BOOK LOSS OR BOOK PROFIT.

The witness Samuel R. Miles testified that market conditions were out of his line (Tr. 203).

Exhibit 22 must remain out of the case in the consideration of losses and profits of the Batterson Mill until it is established by evidence of the quantum and quality stated in the above mentioned authorities, that the Batterson Mill made actual profits prior to the time this controversy arose.

It is submitted that Exhibits 19a, 19b, and 19c do not afford any evidence for the purpose intended. And, of course, it must follow that witness Roy Gould's testimony does not add anything thereto. Therefore, there is no competent evidence to support a finding of loss or profits in any sum whatever. And finally such testimony in response to Counsel's leading question above quoted, "By buying logs on the open market down there . . .", and the response, "No, we were out of logs at times . . ." should be subjected to the rule, "A reviewing court is not always required to accept as substantial evidence the opinion of experts, "Where it clearly appears that an expert's opinion is opposed to physical facts or to common knowledge, or to the dictates of common sense or is pure speculation, such an opinion will not be regarded as substantial evidence." *United States v. Thornburg* (CCA 8, 1940), 111 F. (2d) 278, p. 280. For sawmill logs are so plentiful at a market price that Gould could not be out of logs because they were not available. It is common knowledge that the kind of logs. #2 mill old growth fir logs used by the Batterson Mill (Tr. 156) are in continuous supply to buyers at established market prices.

SPECIFICATION OF ERROR NO. II

The Court erred in finding that plaintiff sustained the amount of $118,000 for loss of profit of the operation of its mill at Batterson according to Finding No. XII (Tr. 88), and concluding that defendants McKenney and Glaser are liable thereof according to Conclusion of Law XI, page 93 in that the finding is against the weight of the evidence.

Argument

The points and authorities and the argument under Specification of Error No. I hereinabove are hereby made applicable with the additions hereinbelow made in the event that the Court determines there is some substantial evidence to support the finding.

The defendant Bart McKenney (Tr. 302). testified on direct examination as witness for defendants to the question, "Was there any other possible market to purchase at Batterson in the months of October and November, 1951, at the market price," that, "Well, on the railroad there is several independent operations. There is another operation within nine miles of them, an independent operation. And Tillamook County has got—there are several in Tillamook County that ship their logs up by rail. There is no reason why by paying the market price there shouldn't have been a market—there shouldn't have been logs." It is submitted that the substantial loss during Gould's operation was not mainly due to inability to get good logs.

Further, Bart McKenney testified that the Buffelen people had discouraged the partners, McKenney and Glaser in the partners' consideration of the purchase of the mill by telling them that Buffelen had never made a profit on it "except one month" (Tr. 366). And on the direct examination McKenney testified that Mr. Holm was the one who had so told him, "That is one of the things he used to beat down the price of the logs" (Tr. 368).

SPECIFICATION OF ERROR NO. III

The Court erred in admitting plaintiff's Exhibits Nos. 19a, 19b, and 19c. Exhibits Nos. 19a, 19b, and 19c are each tabulations entitled "Batterson Cost Report for the Twelve Months Ended June 30, 1949, June 30, 1950 and June 30, 1951 respectively." (See appendix this brief). The offer in evidence (Tr. 210) was made during examination by plaintiff of Samuel R. Miles, Assistant Secretary-Treasurer and Accountant for Buffelen (Tr. 201):

> "Mr. Prendergast: If the Court please, I would like to inquire of Counsel as to the purpose of this offer.
>
> Mr. Dezendorf: We contend that we are entitled to recover loss of profits to the mill from the partnership with respect to any logs which were not tendered to us for purchase and which we attempted to purchase and were unable to, and that (40) we are entitled to recover against the defendant corporation for loss of profits to the mill from the time that it took over the alleged McKenney operations until now.
>
> Mr. Prendergast: If the Court please, we object to this offer of Exhibits 19-A, 19-B, and 19-C on

the ground that they are wholly immaterial to any issue in this case; particularly that these purported profit-and-loss statements would not be the measure of any damages that would arise, and cover a period which is apparently not in controversy, either in the original pleadings which are superseded by the pre-trial order, or by the pre-trial order. They cover periods not in controversy.

Mr. Dezendorf: If the Court please, we feel that we have to show the historical background of the operation of the mill in order to support the testimony of the witnesses as to what the loss from the failure to operate would be during a period when we were unable to get logs. They are offered for the purpose of supporting the testimony of the witness as to what the anticipated profits would have been if they could have operated.

The Court: There is always great difficulty in proving anticipated profits and basing damage claims thereon. The Oregon rule has always been very liberal, and I am inclined to think it is competent. It may be that they will not support the weight of the conclusion, but nevertheless they are (41) competent for admission. Admitted."

The following developed during the cross-examination of witness Miles in connection with said exhibits, record of such cross-examination appears on page 204, transcript of record:

"The Court: Aren't the books here?

Mr. Dezendorf: Yes. Of course, as the witness has testified earlier, these figures that we have go up through June of 1951. The Batterson mill was not operated thereafter.

The Court: I understand, but then aren't the books here?

Mr. Dezendorf: The books are not here, no.

The Court: I understood you to say before that they were.

Mr. Dezendorf: But the monthly records that

support the figures that we have are attached to those few exhibits. The mill was not operating in July or August of 1951, is the answer to this question.

The Court: All right."

Argument

The objection should have been sustained. The exhibits were not competent evidence for any purpose in the case. It is apparent on the face of each exhibit including the "attached" "monthly records," that it is a record of inter-departmental transactions showing transfer of lumber from yard to yard within the plaintiff's organization. Each exhibit has the designation of the results of the calculations thereon as Book Profits or Book Losses. Transfer of manufactured lumber from yard to yard or about the yard of the Batterson mill cannot be made the basis for a write-up to support a claim for loss of profits until there is some evidence that the figures, from which the cost of lumber was deducted for the purpose of showing such profits, were market prices or market value figures. No presumptions can aid the plaintiff here.

The statement by plaintiff's counsel, above made, that "They are offered for the purpose of supporting the testimony of the witness as to what the anticipated profits would have been if they could have operated," we apprehend refers to plaintiff's witness Ray Gould's testimony. Clearly witness Gould's testimony added nothing to the exhibits and the exhibits added nothing to Gould's testimony.

SPECIFICATION OF ERROR NO. IV

The Court erred in finding that Appellee sustained damages in the amount of $118,000 loss of profits in the operation of its mill at Batterson, Oregon by the attempted sale by McKenney and Glaser of their interest in the properties described in the contract, Exhibit 1, and that McKenney and Glaser became liable for such loss of profits; and the Court erred in its conclusion of law that defendants McKenney and Glaser are liable to plaintiff for $168,000 damages (of which $118,000 is a part thereof) sustained by it and specified in Finding of Fact XII by reason of the breach of the contract, which is plaintiff's Exhibit 1, by reason of the attempted sale and conveyance on September 1, 1951 to defendant McKenney Logging Corporation (Finding of Fact XII, Tr. 88, 93); and the Court erred in awarding judgment thereon, in that loss of profits is not the proper measure of damages in this case for the timber to be sold to the Plaintiff-Appellee had at all times an established and ready market and there was a readily determinable market price for the goods in question. The finding is clearly erroneous.

Points and Authorities

1. Where there is an available market for the goods in question, the measure of damages for failure to deliver goods contracted for, in the absence of special circumstances showing *proximate* damages of a greater amount, is the difference between the contract price and

the market or current prices of the goods at the time or times when they ought to have been delivered, or if no time was fixed, then at the time of the refusal to deliver.

Section 71-167 O.C.L.A.
75.670 Oregon Revised Statutes } (Section of Uniform Sales Act)

Watson v. Oregon Moline Plow Co., 112 Ore. 416, p. 432, 227 P. 278 at p. 284.
Norwood Lumber Corporation v. McKean, 153 F. (2d) 753.

2. Plaintiff must show lack of available market as part of plaintiff's case.

Norwood Lumber Corporation v. McKean, 153 F. (2d) 753.

3. Even though no market exists at the place where delivery was due, the nearest available market furnishes the basis under such circumstances, the expense of obtaining and transporting the goods from that market to the place where delivery is due being added.

Williston on Contracts (1937), Sec. 1384, p. 3873.
Williams v. Pacific Surety Co., 77 Or. 210 at 220, 146 P. 147 and 149 P. 524 at 526.

4. In Oregon the party claiming damages must prove them.

Austin v. Bloch, 165 Ore. 116, 119, 105 P. (2d) 868 at 869.

Argument

The Plaintiff-Appellee by its own evidence in the instant case proved almost to the point of demonstration that there was an available market where the logs might have been purchased in order to keep the Batter-

son mill in continuous operation for the period for which the District Court awarded damages for loss of profits of $118,000. Such proof is due in part in that the record is replete with testimony and documentary evidence that the kind of logs used in the Batterson mill was #2 old growth fir saw logs. There are numerous scale sheets in the record as exhibits, but for convenience, reference here will be made only to plaintiff's Exhibit 4 which consists of Scale Sheet by Handler & Schneider and is set out at page 156 transcript of record. There is no dispute that the logs were properly scaled and it may be observed from the scale sheet itself there was nothing unusual about the logs for immediately before the signature of scaler, A. V. Schneider appears the following which we quote:

> "This is to certify that the above was scaled and graded, and the measurements and grades as therein set forth have been determined in a careful manner without fear or favor according to the standard rules for the scaling and grading of logs."

Therefore the logs to be sold and to be purchased by Buffelen were ordinary fir logs such as were available then and have been continuously and will be available so long as there is timber in Tillamook County, or other parts of Oregon or elsewhere.

On page 154 of the record as part of plaintiff's Exhibit 4 is a check made by the Buffelen Manufacturing Company, No. 26662, in voucher form payable to the McKenney Logging Company for $19,379.86. The voucher shows that $18,791.54 thereof is for the price of logs per attached statement, and the attached statement

is the above mentioned Scale Sheet by Handler & Schneider. The balance of $776.24 is made up of rafting and booming charges on 388,120 feet less 1% discount on the $18,791.54. Such were the usual transactions prior to the controversy herein. Buffelen purchased and the McKenney Logging Company sold at market prices.

The contract, Exhibit 1 (Tr. 131, par. c and d of contract), states that the Lumber Company agrees to purchase from the Loggers all merchantable fir logs except those dumped in the company's mill pond at Batterson which the Loggers may remove from either their lands or the lands of the Lumber Company at the market price for such logs on cars at the Loggers reload at Batterson, or the Lumber Company may, at its option, have any of the said logs which it may select dumped in its log pond at Batterson. Also the Lumber Company agreed to purchase from the Loggers all merchantable fir logs which the Loggers may remove from either their land or the lands of the Lumber Company and are dumped into the Lumber Company's pond at Batterson at the said market price of logs on cars at Batterson less $0.50 per thousand.

Throughout the dealings between Buffelen and the partners it is undisputed that the logs purchased by Buffelen and sold by the partners to Buffelen were bought and sold at the current market price. In fact, 55,546,171 feet were so sold to Buffelen for more than 2½ million dollars (Exhibit 16, Tr. 391).

In 1951, 15,216,540 feet were so sold for $758,498.67 (Plaintiff's Exhibit 16, Tr. 391). Of course, the market

price was not a negotiated price between Buffelen and the Loggers but was a price entirely determined by current market conditions in the entire lumber industry. In *Norwood Lumber Corporation v. McKean,* 153 F. (2d) 753, (at page 756), there was a question whether or not there was any available market at all where the buyer could have purchased the lumber. The action there was brought for breach of contract. Plaintiff purchased a quantity of lumber from the defendants. Before delivery to plaintiff defendants sold the lumber to another. The District Court directed a verdict in favor of defendants, and was reversed. The Court pointing out there was some testimony by a witness who testified that "he knew that country and had for years, and knew that there was no such thing as lumber like that," and also there was some further testimony that "one of the defendants, said that he did not know where he could go and buy 50,000 feet of seasoned oak in the community." The United States Court of Appeals (3rd Circuit) decided that this testimony tended to show the lack of available market at which one could purchase such lumber in the community and commented that the jury might have accepted such testimony or the defendants might have smothered it.

It is submitted that the above figures offered by the plaintiff that Buffelen had purchased over 55 million feet of logs at current market prices conclusively shows there was a market where the prices of such logs was established and it necessarily follows that Buffelen could have purchased any quantity of #2 old growth fir

sawmill logs at the market prices in order to keep the Batterson mill in continuous operation when and if such logs were not made available to Buffelen by McKenney and Glaser: And there being an available market where such logs could be purchased the correct measure of damages in the instant case is not one for loss of profits but that the measure of damages is the one made by Sec. 75.670 Oregon Revised Stautes, and to be applied as stated by the United States Court of Appeals, Third Circuit in *Norwood Lumber Corporation v. McKean,* supra. Section 75.670 Oregon Revised Statutes and the Section of the Uniform Sales Act analyzed in *Norwood Lumber Corporation v. McKean* are the same. We quote 71-167 of Oregon Complied Laws Annotated (1940) which is now 75.670 Oregon Revised Statutes (1953):

"ACTION FOR FAILING TO DELIVER GOODS.

"(1) Where the property in the goods has not passed to the buyer, and the seller wrongfully neglects or refuses to deliver the goods, the buyer may maintain an action against the seller for damages for nondelivery.

"(2) The measure of damages is the loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract.

"(3) Where there is an available market for the goods in question, the measure of damages, in the absence of special circumstances showing proximate damages of a greater amount, is the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered, or, if no time was fixed, then at the time of the refusal to deliver.

(L. 1919, ch. 91, Sec. 67, p. 95; O.L. Sec. 8228; O.C. 1930, Sec. 64-705)."

The Oregon cases involving questions of loss of profits and use value of premises are not applicable to the factual situation involved here, for in the final analysis all that the defendants McKenney, Glaser can be held liable for, if at all, is the failure to offer a readily marketable product, to the plaintiff, which the plaintiff could have at all times purchased in the open market, at the current market prices, therefor.

Since and before *Watson v. Oregon Moline Plow Co.,* 112 Ore. 278, p. 432, 227 P. 278, it has been the law in Oregon that if there is an available market for the goods contracted for which the seller fails to deliver, the rule of damages is as set out in the applicable portion of the Uniform Sales Act which in the instant case is 75.670 Oregon Revised Statutes.

It may be anticipated that plaintiffs will make the same contention here as was made by the plaintiff in *Norwood Lumber Corporation v. McKean,* 153 F. (2d) p. 755, that although there was a market where the logs could be purchased from other sellers than the defendants that this fact is a matter for mitigation of damages and that the burden showing mitigation is upon the party showing mitigating circumstances. The United States Court of Appeals said in *Norwood Lumber Corporation v. McLean,* supra, in response to such argument:

"This is the wrong analysis. Mitigating circumstances are not involved here. It lies upon the one

> asserting damages to prove them. Plaintiff must show a market price, if there is one, to establish its damages of the difference between contract price and market price. If there is no market price and plaintiff claims damages on some other basis, it must show the facts, both as to he absence of market and those on which some other measure of damages may be based."

The Court further stated at page 757:

> "We do not mean to say that a plaintiff buyer can recover prospective profits at its option. The usual measure of damages is established by the statute as already stated. But if the plaintiff proves lack of a market where it can get the goods from another, it is thrown perforce to a more elaborate measure of damages. We think the trial court unduly restricted the plaintiff in its attempt to prove its question in this instance."

The Plaintiff-Appellee was not so restricted or restricted at all in its proof and as above stated, there was and is a market to both buyers and sellers for practically any quantity of #2 old growth fir logs.

Sufficient such logs were available at the Batterson Mill (Tr. 302), but if there had not been, it is submitted that the rule stated by Williston, Sec. 1384, page 3874, furnishes the basis under such circumstances. The rule of the expense of obtaining and transporting the goods from that market to the place where delivery is due being added becomes applicable.

Williams v. Pacific Surety Co., 77 Or. 210, 220, 146 Pac. 147, 149 Pac. 524, so holds.

SPECIFICATION OF ERROR NO. V

The Court erred in Finding No. XII wherein the Court found that plaintiff sustained damages of $50,000 for timber removed by defendant McKenney Logging Corporation by reason of breach of the contract, Exhibit 1, and by the attempted sale by defendants McKenney and Glaser of their interest in the properties the rights covered by the contract to McKenney Logging Corporation, in that such finding is clearly erroneous, for it is based upon a misconstruction of the contract.

The Court also erred in making Conclusion of Law XI and the judgment based thereon.

Points and Authorities

1. Plaintiff's Buffelen, right to the timber for which the $50,000 of the damages was awarded against McKenneys and Glasers, was only the right to refuse to purchase and pay the market price therefore. This was the construction placed on Exhibit 1, the contract, by the parties in their dealings with respect to the timber involved. Such construction should be adopted.

Lease v. Corvallis Sand & Gravel Co., 185 F. (2d) 570, 576, 9th Cir.

2. The effect of the findings and conclusions of law in this case is that the contract, Exhibit 1, was at all times in full force and effect, and therefore Finding No. XII as to the $50,000 damages sustained by plaintiff is

inconsistent with all other applicable findings and conclusions of law herein. If the timber, 2,000,000 feet for which the $50,000 was awarded had not been removed and was still on the lands, the partners would have the right to under the contract cut such 2,000,000 feet, offer it to Buffelen, and whether Buffelen purchased it or not, the partners would be paid the $50,000, presuming that $25 is the market price per thousand feet therefore. Compensation is the guiding rule in damages.

> Title & Trust Co. v. U. S. Fid. & Guaranty Co., 138 Or. 467, 500, 1 P. (2d) 1100, 7 P. (2d) 805, 811.

Argument

The District Court held that the contract was not a security transaction and construed the contract adversely to defendants' issue of law IX, pre-trial order (Tr. 26). But the fact remains, as above stated that the Court has in effect held the contract is in full force. Under the contract the partners were at all times entitled to the $50,000 whether Buffelen bought the 2,000,000 feet of logs in question or not. All Buffelen had was the right to purchase or refuse to purchase the logs produced by the partners, McKenney and Glaser. We have cited *Title & Trust Co. v. U. S. Fidelity & Guaranty Co.,* 138 Or. 467 for the statement therein at page 500, where the Court says:

> "We have carefully read all the authorities cited and find none that changes the principle that 'compensation is the guiding rule in damages.' " (Citation omitted)

Except in cases fit for punitive damages, compensation to repair the loss is, of course, the rule. If Buffelen is entitled to any damages at all, the most such damages should amount to is the value of the right to purchase, which is all that Buffelen could have lost if the logs were not tendered to it for purchase. As already pointed out, if Buffelen had purchased the logs, Buffelen would have had to pay the $50,000 to the partners. Buffelen has no right to an unjust enrichment of the $50,000.

SPECIFICATION OF ERROR NO. VI

The Court erred in rejecting defendants' offer of pretrial Exhibit No. 24. Tr. 554-567 inclusive.

Points and Authorities

The exhibit was admissible as an aid to interpreting contract, Exhibit 1.

2-218 O.C.L.A.

2-218 Oregon Compiled Laws Annotated:

> "For the proper construction on an instrument, the circumstances under which it was made, including the situation of the subject of the instrument, and of the parties to it, may also be shown, so that the judge be placed in the position of those whose language he is to interpret."

Williston on Contracts (1937), Section 629, p. 1804.

Argument

While the Exhibit No. 24—rejected—was offered after the case had been submitted and at the close of

the argument, the Court in the exercise of its discretion, ruled upon the offer. In a case tried partly on the security transaction theory as was done here, Exhibit No. 24 was clearly material. And as above stated it was admissible as an aid in interpreting the contract, Exhibit 1.

SPECIFICATION OF ERROR NO. VII

The Court erred in construing the contract Exhibit 1, so that, the contract by its terms contemplated that the partnership would become liable for loss of profits in the operation of the Batterson mill if the partnership failed to offer logs to the plaintiff.

SPECIFICATION OF ERROR NO. VIII

Tht Court erred in construing the contract so that no interest in the timber and timber lands and facilities vested in the partnership, and that the contract granted only cutting rights to the partnership.

SPECIFICATION OF ERROR NO. IX

The Court erred in finding that the use value of the mill based upon loss of profits was the measure of damages herein.

SPECIFICATION OF ERROR NO. X

The Court erred in entering judgment against the defendant McKenney Logging Corporation, without providing in such judgment that payment in excess of

$100,000, thereon should be applied pro tanto upon the judgment of $168,000, against the partnership defendants for the findings do not support such duplication of $168,000, and there is no evidence upon which to base such duplication. The error is apparent on the face of the judgment in that the provisions of the judgment do not follow the findings and conclusions of law.

SPECIFICATION OF ERROR NO. XI

The Court erred in not granting Appellants' Bart McKenney and Marie McKenney Motions for Amendments to the Judgment and Decree, and for a new trial.

SPECIFICATION OF ERROR NO. XII

The Court erred in entering judgment against the defendants, Bart McKenney, Marie McKenney, Einar Glaser, and Dorothy Glaser in the sum of $168,000, in that the findings upon which said judgment is based, are clearly erroneous, and not supported by substantial evidence.

SPECIFICATION OF ERROR NO. XIII

The Court erred in admitting into evidence Exhibit No. 22, which is discussed under Specification of Error No. I hereof. It is a statement entitled "Results of operation of the Batterson Mill from June 1, 1951 to October 30, 1952. The offer, the objections thereto, and the ruling thereon appear on pages 475 to 479, inc.

CONCLUSION

It is respectfully submitted that the judgment and decree herein that plaintiff have and recover judgment against the defendants Bart McKenney, Marie McKenney, Einer Glaser and Dorothy Glaser, and each of them, jointly and severally for the sum of $168,000, be reversed.

It is respectfully submitted that the plaintiffs are not entitled to damages herein under the facts and the applicable law, and that the Appellants Bart McKenney and Marie McKenney are entitled to have the contract, Exhibit 1, construed pursuant to the rules of law hereinabove stated, and that the Judgment and Decree of the District Court be corrected as contended for by the Appellants Bart McKenney and Marie McKenney herein. A new trial should be granted.

Respectfully submitted,

THEODORE B. JENSON,
DEWEY H. PALMER,
DAVIS, JENSEN & MARTIN,

Attorneys for Appellants,
Bart McKenney and Marie McKenney.

, 1949

	YEAR TO DATE		
	QUANTITY	AMOUNT	AVERAGE
Mate	LOG FEET		
L	8,062,466	$ 245,271.09	$ 30.42
O	65,247	- 0 -	- 0 -
	8,127,713	$ 245,271.09	$ 30.18
Pay	BOARD FEET		
S		$ 7,020.68	$ .86
S		77,015.95	9.48
I		10,236.19	1.26
M		11,329.64	1.39
P		4,408.12	.54
		$ 110,010.58	$ 13.53
Man			
R		$ 33.27	$ .01
S		1,565.83	.19
O		9,879.95	1.22
M		17,697.87	2.18
M		6,133.99	.75
		$ 35,360.91	$ 4.35
Fix			
D		$ 42,590.21	$ 5.24
I		11,920.59	1.47
F		57.46	- 0 -
T		2,000.00	.25
		$ 56,568.26	$ 6.96
		$ 5,013.22	$ .62
Mis	8,127,713	$ 449,093.39	$ 55.25
	719,473	35,160.76	48.87
Add	366,043	10,866.27	29.69
Ded	8,579,654	$ 473,387.88	$ 55.18
			VALUE REALIZED
Dis			
T	5,358,569		$395,863.45
S	3,122,574		75,506.94
S			(11,010.90)
	8,481,143	$ 473,387.88	$460,359.49
P	98,511	6,895.77	
	8,579,654	$ 466,492.11	$460,359.49
			$ 6,132.62
Log			

1949

YEAR TO DATE		
QUANTITY	AMOUNT	AVERAGE
LOG FEET		
8,062,466	$ 245,271.09	$ 30.42
65,247	- 0 -	- 0 -
8,127,713	$ 245,271.09	$ 30.18
BOARD FEET		
	$ 7,020.68	$ .86
	77,015.95	9.48
	10,236.19	1.26
	11,329.64	1.39
	4,408.12	.54
	$ 110,010.58	$ 13.53
	$ 33.27	$ .01
	1,565.83	.19
	9,879.95	1.22
	17,697.87	2.18
	6,133.99	.75
	$ 35,360.91	$ 4.35
	$ 42,590.21	$ 5.24
	11,920.59	1.47
	57.46	- 0 -
	2,000.00	.25
	$ 56,568.26	$ 6.96
	$ 5,013.22	$ .62
8,127,713	$ 449,023.39	$ 55.25
719,473	35,150.76	48.87
366,043	10,866.27	29.69
8,579,654	$ 473,337.88	$ 55.18
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5,358,569		$395,863.45
3,122,574		75,506.94
		(11,010.90)
8,481,143	$ 473,337.88	$460,359.49
98,511	6,825.77	
8,579,654	$ 466,512.11	$460,359.49
		$ 6,132.62

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65,247	- 0 -	- 0 -
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	$ 5,013.22	$ .62
8,127,713	$ 449,003.39	$ 55.25
719,473	35,150.76	48.87
366,043	10,856.27	29.69
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LOG FEET		
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8,579,654	$ 473,337.88	$ 55.18
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3,122,574		75,506.94
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8,481,143	$ 473,337.88	$460,359.49
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		$ 6,132.62

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98,511	6,025.77	
8,579,654	$ 466,522.11	$460,359.49
		$ 6,132.62

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98,511	6,865.77	
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No. 14188

In the

United States Court of Appeals

For the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

APPELLEE'S BRIEF

in Answer to Brief of Appellants
Bart McKenney and Marie McKenney.

Appeals from the United States District Court
for the District of Oregon

HONORABLE JAMES ALGER FEE, Chief Judge

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for the District of Oregon

HONORABLE JAMES ALGER FEE, Chief Judge

JURISDICTION

This is a suit in equity for injunctive relief and incidental damages brought in the United States District Court for the District of Oregon by appellee Buffelen Manufacturing Co. (hereafter called "Buffelen"), a California corporation, against Edward M. Buol, a citizen of Washington, appellant McKenney Logging Cor-

poration (hereafter called "the corporation"), a Washington corporation, J. B. Carr, a citizen of Oregon, and appellants Bart and Marie McKenney (hereafter called "the McKenneys") and Einar and Dorothy Glaser, citizens of Oregon. The amount in controversy exclusive of interest and costs exceeds $3,000.00 (Tr., pp. 10-11, 86).

Said appellants have appealed from the final Judgment and Decree of that Court (Tr., pp. 95-96, 107-108, 115-116).

The District Court acquired jurisdiction under 62 Stat. 930, 28 U.S.C.A. §1332. This Court acquired jurisdiction under 62 Stat. 929, 28 U.S.C.A. §1291.

APPELLEE'S STATEMENT OF THE CASE

A. Preliminary Statement.

Appellants Bart and Marie McKenney have presented an extended Statement of the Case containing factual assertions and arguments largely irrelevant to the Specifications of Error available to them.

Of the Specifications supported by argument, those numbered I, II, III, IV and V relate only to the damages allowed by the trial court and the evidence relating thereto.

In Specification VI (McK. Br., p. 43), appellants object to the exclusion of "Pre-trial Exhibit No. 24."

Specifications VII, VIII, IX, X, XI, XII and XIII (McK. Br., pp. 44-45) are wholly unsupported by authorities or argument. These Specifications are therefore abandoned and present no question for the consideration of this court. *Peck vs. Shell Oil Co.*, 142 F.2d 141 at pp. 143, 144 (C.C.A. 9 1944); *Smith vs. Royal Ins. Co.*, 93 F.2d 143 at p. 146 (C.C.A. 9 1937).

In addition, Specifications VI and XIII are improper and should not be considered, because they fail to quote either the full substance of the evidence in question or the grounds urged at the trial for the admission or rejection of the exhibits in question as required by Rule 20(2)(d) of this Court. *Peck vs. Shell Oil Co.*, supra, 142 F.2d 141 at p. 143 (C.C.A. 9 1944); *Jung vs. Bowles*, 152 F.2d 726 at p. 727 (C.C.A. 9 1946); *Butler vs. United States*, 108 F.2d at p. 28 (C.C.A. 8 1939).

Appellee will submit a supplementary Statement of the Case when answering the brief of the other appellants, if the Specifications and contents of that brief require it. Appellee will here correct and amplify the McKenneys' Statement of the Case only as it relates to their first six Specifications of Error.

B. Correction of the McKenneys' Statement of the Case.

The McKenneys assert in their Statement of the Case (McK. Br., p. 8) that Buffelen paid the partners $3,490,-991.88 for 55,546,171 feet of logs under the contract of January 8, 1948, and that it paid the market price without deductions other than sums representing repayment of advances in the amounts of $120,000.00 and $24,000.00. On the contrary, the amount actually paid was $2,490,991.88 (Tr. p. 391), and the contract provided that logs delivered to Batterson should be paid for at the market price less an agreed discount of $.50 per thousand (Tr., p. 132). There is nothing to indicate that this discount was not taken on all logs.

Secondly, the contract provided that stumpage payments were to be deducted from the price of *all* logs delivered at Batterson (Tr., pp. 130-131). The partners, however, prepaid these stumpage charges in the course of their earlier deliveries (Tr., pp. 12, 87, 283). The contract also provided that *after the land was completely logged-off or operations otherwise ceased* the partners should be entitled to a conveyance of *logged-off land* for a nominal consideration (Tr., p. 132). Buffelen therefore was to retain title to the land until the partners had completely performed their contract.

It is also asserted (McK. Br., pp. 9-10) that the Dis-

trict Court held the McKenneys liable as trespassers and entered judgment against them for $50,000.00 and yet held them liable as owners of the same logs for failure to deliver them.

Briefly stated, the McKenneys did not earn their money. The contract required them to cut and deliver logs. They could never deliver logs which were cut and removed by the corporation. Furthermore, as will be seen hereafter, they were held liable, not as original trespassers, but for breaching their covenant not to assign their rights and thereby causing and making it possible for the corporation to trespass against the timber. The land and timber stood in Buffelen's name, and the partners had no rights in it until they performed the contract. The damages for trespass are based upon the value of the converted timber and are unrelated to those caused by their failure to supply the mill with logs. *The McKenneys do not deny liability for the corporation's acts.* They only assert the right to set off against those damages their own rights in the timber, and this they cannot do.

QUESTIONS PRESENTED

1. Does the evidence sustain the trial court's finding that appellee was damaged in the amount of $118,-

000.00 by appellants' breach of their contract to cut and deliver logs to appellee's mill at Batterson, Oregon?

2. Were Exhibits 19a, 19b and 19c, being financial statements showing the profits earned by the Batterson mill from July 1, 1948 to June 30, 1951, admissible to establish earnings lost after October 1, 1951 by reason of appellants' breach of their contract to cut and deliver logs to appellee's mill at Batterson, Oregon?

3. Was appellee entitled to recover earnings of the Batterson mill lost by reason of appellants' breach of their contract to cut and deliver logs to appellee's mill at Batterson, Oregon?

4. Was appellee entitled to recover from the partners the value of logs cut and removed from appellee's land by appellant corporation?

5. Did the trial court abuse its discretion in failing to reopen the case and receive evidence alleged to be newly discovered?

ARGUMENT

I.

The evidence abundantly supports the finding of the trial court that Buffelen sustained damages in the operation of its Batterson mill in the amount of $118,000.00 by

reason of appellants' failure to cut and deliver logs in accordance with the contract of January 8, 1948 (Specifications of Error I and II).

SUMMARY

A. The evidence.

B. The finding is presumed to be correct and must be sustained unless clearly erroneous.

C. Oregon law permits recovery of earnings lost by reason of a breach of contract.

D. Appellee was entitled to recover the use value of the mill as established by its past record of earnings, together with all losses actually sustained.

E. The evidence abundantly supports the trial court's finding.

A. The evidence.

The contract (Tr., pp. 125 et seq.) recites that Buffelen purchased the tracts to supply its Tacoma and Batterson operations and built the mill at a cost of $150,000.00 in reliance upon the partners' promise to cut and deliver logs and to give it the first option on all logs cut from the land. It was understood that no other logs were available (Tr., pp. 129, 135, 139).

Exhibits 19a, 19b, 19c and 22 were prepared directly from the books of the company to show the financial performance of the mill from July 1, 1948 to October 31, 1952 (Tr., pp. 200-201, 462). They show average monthly earnings of 9,000.00 during the fiscal year ending June 30, 1950, and $6,000.00 in the following year. They are based upon the amount of actual operating time, and accurately report costs incurred in the operation of the mill (Tr., pp. 481-482). Prior to the shutdown in June, 1951 the mill had operated on a two- and three-shift basis. (Tr., pp. 214-216). From November 30, 1951 through October 31, 1952, the Batterson mill suffered net operating losses in the amount of $30,533.00 (Tr., p. 480).

Roy Gould, who gave the operating instructions at Batterson as a prospective purchaser of the mill in October and November, 1951, testified that the mill would earn $8,000.00-$10,000.00 per month on a one-shift basis and $14,000.00-$17,000.00 on a two-shift basis if there were a proper log supply (Tr., p. 220). However, he could buy only a few defective logs from Yunkers and Weeks, and as a result the mill could not be operated continuously and lost money during that period (Tr., pp. 220-222, 225-227). Mr. Gould knew Buffelen had demanded logs during the summer of

1951 and initiated his operation believing that deliveries would be made (Tr., pp. 220, 232-233).

He also testified that the market price for lumber rose during 1951 (Tr., p. 221) and that stumpage from Section 6, T. 2 N. R. 7 W. (land standing in Buffelen's name and subject to the contract from which the corporation removed 2,000,000 feet of timber) was worth $25.00 per thousand (Tr., p. 223).

The partners' failure to deliver logs prevented the sale of the mill to Mr. Gould's Diamond Lumber Co. for $250,000.00, since the anticipated sale was predicated upon an adequate log supply (Tr., pp. 231-232, 237). Appellant McKenney testified that the mill was not worth $250,000.00, (Tr., p. 367). Under the terms of the proposed sale, Buffelen was to retain the right of all shop lumber cut at Batterson for use in its Tacoma plant and was theretofore to have a continuing interest in the performance of the contract (Tr., pp. 255-256).

Appellant McKenney testified that the partners were cutting 150,000 to 250,000 feet per day. He denied that the Yunker logs bought by Gould were different from Buffelen's and asserted that other logs were available in the Batterson area (Tr., pp. 301-302).

Two of Buffelen's employees made extensive and persistent efforts to secure logs from other sources, and

they purchased all available logs (Tr., pp. 464-475). They could secure only enough to supply a partial one-shift operation after April, 1952, although Buffelen wished to operate on a two-shift basis (Tr., pp. 470, 474). Furthermore, they were unable to accumulate an inventory which would permit the mill to operate during a strike or a period of fire weather (Tr., pp. 470-471). McKenney Legging Corporation sold its production to National Forest Products, which refused to sell to Buffelen except under wholly uneconomic and unacceptable conditions (Tr., pp. 341-343).

Arnold Magnuson testified that approximately 2,000,000 feet were removed from the Belding (Section 6) tract (land owned by Buffelen and subject to the contract) where he had been cutting as a subcontractor under the partners prior to the attempted sale to the corporation (Tr., pp. 512-515).

B. The finding is presumed to be correct and must be sustained unless it is clearly erroneous.

The findings of the trial court are presumptively correct. Rule 52 F.R.C.P. (which applies to both legal and equitable causes, *Grace Bros. vs. Commissioner*, 173 F.2d 170 at pp. 173-174 (C.A. 9 1949)), provides that findings shall not be disturbed unless "clearly erroneous." *Columbian Nat'l. Life Ins. Co. vs. Quorndt*, 154

F.2d 1006 at pp. 1006-1007 (C.C.A. 9 1946); *Universal Pictures Co. vs. Cummings*, 150 F.2d 986 at p. 987 (C.C.A. 9 1945).

Rule 52 means that findings

> "* * * will not be disturbed if supported by substantial evidence." (*Pacific Portland Cement Co. vs. Food Machinery & Chemical Corporation*, 178 F.2d 541 at p. 548 (C.A. 9 1949)).

It also applies to determinations of the weight of the evidence (*Graver Tank & Mfg. Co. vs. Linde Air Products Co.*, 339 U.S. 605 at pp. 609-610, 70 Sup. Ct. 854, 94 L. Ed. 1097 (1950)) and to conclusions based upon documentary evidence (*U.S. vs. U. S. Gypsum Co.*, 333 U.S. 364 at p. 394, 68 S. Ct. 525, 92 L. Ed. 746 (1948)). See also *West vs. Conrad*, 182 F. 2d. 255 (C.A. 9 1950). The rule

> " * * * requires us to give due weight not only to conclusions drawn by the trier of facts from contradictory testimony, but also to inferences made from testimony which does not stand contradicted directly, but the validity of which is impugned by other evidence in the record, or by legitimate inferences from admitted facts. * * *" (*United States vs. Fotopulos*, 180 F.2d 631 at p. 634 (C.A. 9 1950)).

Furthermore, the finding attacked herein was made after two trials, thorough briefing of the law and the

facts and prolonged deliberation. It can only be reversed if based upon an obvious error of law or a serious mistake of fact. *Gila Water Co. vs. International Finance Corp.*, 13 F.2d 1 at p. 2 (C.C.A. 9 1926); *Easton vs. Brant*, 19 F.2d 857 at p. 859 (C.C.A. 9 1927); *Graff vs. Town of Seward*, 20 F.2d 816 at p. 817 (C.C.A. 9, 1927); *Collins vs. Finley*, 65 F.2d 625 at p. 626 (C.C.A. 9 1933); *Stimson vs. Tarrant*, 132 F.2d 363 at p. 365 (C.C.A. 9 1942). Insofar as the trial court resolved conflicting testimony, the finding will not be disturbed. *United States vs. McGowan*, 62 F.2d 955 at pp. 957, 958 (C.C.A. 9 1933); *Crowell vs. Baker Oil Tools*, 99 F.2d 574 at p. 577 (C.C.A. 9 1938).

C. Oregon law permits recovery of earnings lost by reason of a breach of contract.

In Oregon, as noted by the trial court (Tr., p. 202), the courts are extremely liberal in permitting recovery of earnings lost by reason of a breach of contract. When the fact of damage has been established with reasonable certainty, exact proof of the amount thereof is not required. The Oregon rule in this regard is contrary to that set forth by the Supreme Court of Washington in *National School Studios, Inc. vs. Superior School Photo Service, Inc.*, 40 Wash. 2d 263, 242 P.2d 756 (1952) relied upon by appellants. The wrongdoer cannot defeat

recovery by asserting that the exact amount of the loss he himself has caused cannot be determined.

In *Blagen vs. Thompson*, 23 Ore. 239, 31 Pac. 647 (1892) defendants contracted with plaintiff to build a streetcar line to certain land which plaintiff hoped to develop and sell. Defendants breached the contract, and plaintiff was allowed to recover the amount by which the car line would have increased the value of the property. The court said:

> "As defendants failed and neglected to build the road within the stipulated time, or at all, it may be difficult for plaintiff to prove with exactness what would have been the value of the land with the contract fulfilled; but such uncertainty does not prevent him from recovering such damages as he may be able to prove. He is only required to give such evidence as the nature of the case will permit bearing upon the matter of his damages and legally tending to prove such value: *O'Brien v. Society*, 117 N. Y. 310 (22 N. E. Rep. 954); *Huse Ice Co. v. Heinze*, 102 Mo. 245 (14 S. W. Rep. 756). Where one violates and entirely repudiates his contract with another, the damages sustained by the injured party are, as EARL, J., said, "nearly always involved in some uncertainty and contingency; usually they are to be worked out in the future, and they can be determined only approximately upon reasonable conjecture and probable estimates. They may be so uncertain, contingent, and imaginary as to be incapable of adequate proof, and then they cannot be recovered because they cannot be proved. But when it is certain that damages have been caused by a breach of contract, and the only uncertainty is as

> to their amount, there can rarely be good reason for refusing on account of such uncertainty any damages whatever for the breach. A person violating his contract should not be permitted entirely to escape liability because the amount of the damages which he has caused is uncertain': * * *" (At pp. 253-254)

See also *Blanchard vs. Makinster*, 137 Ore. 58 at pp. 65-67, 290 Pac. 1098, 1 P.2d 583 (1931); *Krause vs. Bell Potato Chip Co.*, 149 Ore. 388 at p. 394, 39 P.2d 363 (1934); *Bredemeier vs. Pacific Supply Company*, 64 Ore. 576 at p. 580, 131 Pac. 312 (1913); *Martin vs. Neer*, 126 Ore. 345 at p. 348, 296 P.2d 342 (1928); 1 Sedgwick on Damages 379 (§199) (9th Ed., 1912).

In *McGinnis vs. Studebaker*, 75 Ore. 519, 146 Pac. 825, 147 Pac. 525 (1915), the court said:

> "The theory of the law is to award compensation for gains prevented and for losses sustained when a contract is broken; and a person breaking a contract is liable for the direct, natural and proximate result of his act. The party damaged is not precluded from recovering anticipated profits merely because they are such, since the loss of anticipated profits is a damage that should be compensated for just as much as is the destruction of property. Repeated decisions of this court, as well as the announcements made by courts in other jurisdictions, have firmly established the doctrine that if the business of which the complaining party was de-

prived was contemplated or could reasonably be presumed to have been contemplated by the parties at the time of making the contract, and if it is reasonably certain that a gain or benefit would have been derived, then damages may be recovered. Uncertainty as to the amount of damages does not prevent recovery, but uncertainty as to whether any benefit or gain would have been derived at all does bar a claim for damages. If it is reasonably certain that a gain or benefit has been prevented, then plaintiff is entitled to damages for the amount of that gain or benefit: * * *" (At pp. 522-523)

In the present case the parties knew that the partners' breach would have disastrous consequences. The contract provides:

"Whereas, the primary purpose of the Lumber Company in the purchase of the timber tracts and land listed in Schedules "A" and "B" is to keep its mill at Tacoma and the mill which it is building at Batterson in logs * * *

* * * * * *

"(a) That the Lumber Company has constructed its saw mill at Batterson in full reliance upon the agreement on the part of the Loggers or their successors in interest to provide the logs needed to keep the Lumber Company's mill in continuous operation on a one-shift basis and in the further reliance upon the agreement on the part of the Loggers to give to the Lumber Company the first right or option to purchase at the market price as herein defined, all of the merchantable fir timber coming from the lands either owned or controlled by the

Loggers or by the Lumber Company for use in its plant at Tacoma or for use in its sawmill at Batterson. * * *

* * * * * *

"* * * Likewise, the Lumber Company has installed their mill at a heavy investment, based upon continuous logging operations and a continuous supply of logs from the Loggers, since the only supply of logs which could possibly keep such mill in operation, outside of that particular timber area owned by the Lumber Company, is the logging right of the Loggers. * * *" (Tr., pp. 129, 135, 139)

See *Martin vs. Neer*, supra, 126 Ore. 345 at pp. 350-353, 269 Pac. 342 (1928). The losses here sued for were therefore within the contemplation of the parties, and appellants are liable for them.

D. Appellee was entitled to recover the use value of the mill as established by its past record of earnings, together with all losses actually sustained.

Under Oregon law, the judgment must be sustained by satisfactory evidence (ORS 41.110), and satisfactory evidence of losses caused by a breach of contract which injures an established business was described in *Williams vs. Island City Milling Co.*, 25 Ore. 573, 37 Pac. 49 (1894), which involved recovery of earnings lost

due to the plaintiff's failure to perform a contract to repair the defendant's sawmill. The court said:

> "* * * The defendant had been operating its mill for several years before the breach of plaintiff's contract, and it can show what its average profits had actually been, and *so ascertain with reasonable certainty* what the value of the use of the mill would have been to it during the time it was prevented from operating it on account of plaintiff's breach of the contract, the effect of the change from the 'burr' to the 'roller' process, as contracted for, being of course taken into account. For this purpose, proof of past profits, if any, were admissible in evidence. While it is true the evidence showed, or tended to show, that the mill had no rental value, within the sense that a business house in a populous city has a rental value, yet its actual value to the defendant could have been ascertained with reasonable certainty by reference to the business which it had previously done. * * * We are of the opinion, therefore, that the true measure of damages for the failure to complete the contract within the time stipulated, and for the loss of time occasioned by the attempts of the plaintiffs, after September twentieth, to comply with the terms of their contract, is the reasonable value of the use of the mill during such time, *as ascertained from the past experience of the defendant.*" (Emphasis supplied.) (At pp. 589-591)

See also *Anderson vs. Columbia Contract Co.*, 94 Ore. 171 at pp. 194-196, 184 Pac. 240, 185 Pac 231 (1919); *Pedro vs. Vey*, 150 Ore. 415 at p. 433, 39 P.2d 963, 46 P.2d 582 (1935); *Mississippi & Rum River Boom Co.*

vs. Prince, 34 Minn. 71 at pp. 76-77, 24 N.W. 344 (1885).

Appellee is therefore entitled to recover from the partners, as the loss proximately caused by their deliberate breach of contract, the use value of the mill as thus established together with all actual operating losses sustained during the period of the breach.

E. The evidence abundantly supports the trial court's finding.

The use value of the mill for two years preceding the wilful and deliberate breach of contract committed by the McKenneys is shown by Exhibits 19a, 19b and 19c. These exhibits were prepared by appellee's accountant from the company's books kept under his supervision (Tr., pp. 200-201). They show that after all adjustments for inventory, depreciation and administrative expense the mill earned a profit in fiscal year 1949-50 of $113,309.75 (McK. Br., p. 49). In fiscal year 1950-51, it earned $75,743.78 (McK. Br., p. 51). The average of these earnings is $7,500.00 per month, and the evidence was undisputed that the market improved during 1951 (Tr., p. 221). Corroboration is found in the testimony of Roy Gould that the mill could and should have earned $8,000.00-$10,000.00 per month on a one-shift basis and $14,000.00-$17,000.00 on a two-shift basis (Tr., p. 220).

Exhibit 22 was also prepared by Buffelen's accountant from the company's books and accurately reflects the operation of the mill from June, 1951 through October, 1952 (Tr., pp. 462, 475). Disregarding the months of October and November, 1951 (when the mill was operated by Roy Gould) and giving the partnership credit for profits actually earned in June, August and September, 1952, it establishes that Buffelen sustained net operating losses between December 1, 1951 and October 31, 1952 in the amount of $30,533.00 (Tr., p. 480).

Having shown the net operating loss, appellee was entitled to recover that loss in addition to earnings lost by reason of the breach. *Hopkins vs. Sanford*, 41 Mich. 243 at pp. 248-249, 2 N.W. 39 (1879).

Exhibits 19a, 19b, 19c and 22 are wholly sufficient and convincing evidence to support the finding of the trial court. They show that losses were sustained in the amount of $30,533.00, and that the use value of the mill for eleven (11) months (December 1, 1951-October 31, 1952) was $82,500.00. Total operating losses were therefore $113,033.00, which is the lowest amount the court could have awarded. Considering also the cost and burden of having two employees devote their time to the task of procuring other logs (Tr., pp. 464-475), it is

apparent that the judgment for $118,000.00 was in no way excessive. Damages in that amount were established by the undisputed evidence.

The McKenneys' objections to the sufficiency of this proof are as follows:

(a) It is apparently contended that Mr. Gould's testimony concerning the mill's earning capacity was insufficient to support the judgment (McK. Br., pp. 19-22), and that his testimony that other logs were unavailable is unworthy of belief (McK. Br., p. 28). In support thereof appellants cite the contradictory testimony of appellant Bart McKenney (McK. Br., pp. 29-30).

While the judgment was not based upon Mr. Gould's testimony, it is supported by that evidence. Exhibits 19a, 19b and 19c are corroborated by Mr. Gould's experienced evaluation of the mill's capacity to make substantial earnings (Tr., pp. 219-220) and by his testimony that the market improved in 1951 (Tr., p. 221).

There is no basis in the record or in fact for the McKenneys' assertion that other logs were available (McK. Br., p. 28). The evidence is conclusive to the contrary. Mr. Gould testified that he bought all available and uncommitted logs (Tr., pp. 222, 227). The contract stated that no other logs were available and that

Buffelen had purchased the timber to supply the Batterson mill (Tr., pp. 129, 135, 139). Mr. Holm and Mr. Gansberg by persistent and energetic efforts could supply only a partial one-shift operation and could accumulate no inventory to carry them through a fire hazard period even on that limited basis. (Tr., pp. 470-471). The conflicting opinion evidence of the interested witness, Bart McKenney, was properly disregarded by the trial court, and the court's resolution of that conflict will not be disturbed.

Finally, Mr. Gould's testimony is conclusive that *the partners' breach of contract caused serious injury to the operation of the mill, that the failure to deliver could and did cause heavy losses.* This evidence is substantiated by the testimony of Mr. Holm and Mr. Gansberg (Tr., pp. 464-475) that insufficient logs could be secured and by Mr. Gould's further testimony that the market improved during 1951 (Tr., p. 221).

(b) The McKenneys complain secondly (McK. Br., p. 22) that Buffelen did not prove the amount of its costs sustained in operating the Batterson mill. This is wholly erroneous. The exhibits set forth the costs incurred (McK. Br., pp. 47-52; Tr., p. 480), and the evidence was uncontradicted that they were accurately reported (Tr., pp. 481-482). There is nothing in the

record or the facts to support the suggestion that available evidence was withheld from the court (McK. Br., p. 21).

(c) The McKenneys suggest that sufficient logs were found to sustain a one-shift operation (McK. Br., p. 25) and that their breach therefore caused no damage. The record shows that the mill was entirely shut down following the Gould operation until April, 1952 (Tr., pp. 470, 480). Furthermore, shutdowns during the succeeding months were caused by Buffelen's inability to secure an inventory which would sustain production during periods when logging operations were interrupted (Tr., p. 470).

Furthermore, appellants' obligation under the contract *was not limited merely to supplying a one-shift operation at the Batterson mill.* They were obligated to give Buffelen the first option on all logs cut from the lands (Tr., p. 134), and the mill was installed on the strength of that promise (Tr., p. 135). Buffelen's timber was to be logged at as early a date as efficient logging would permit (Tr., p. 137). The undisputed facts are that the partners were producing from 150,000 to 250,000 feet per day (Tr., p. 301). The mill could cut 50,000 feet on a one-shift basis and 90,000 feet on a two-shift basis (Tr., p. 220). Buffelen had demanded that their entire production be delivered to Batterson

(Tr., pp. 180-182, 229-230, 250; Exhs. 4, 5, 6, 16, 17, 18). Buffelen purchased all available logs for the mill (Tr., pp. 466, 468, 473-474) and desired to establish a two-shift operation (Tr., p. 474). The partners delivered no part of their production. Specifically, they did not deliver enough logs to supply a one-shift operation, to which Buffelen could have added the few logs secured elsewhere and thereby expand its production. It follows that Buffelen desired and appellants were obligated to supply logs which would sustain a two-shift operation at Batterson. Appellants' contention disregards the facts and the express terms of the contract.

(d) Appellants suggest that the judgment was excessive, because the mill was shut down by a strike during May, 1952 (Tr., p. 480) and by a logging shutdown during October, 1952 caused by fire weather (Tr., pp. 470-471). This justifies no special deduction from the damages sustained, because the use value of the mill rests upon a determination of average earnings. Average monthly earnings were abundantly established by Exhibits 19a, 19b and 19c. Appellants themselves having prevented the mill from operating, they cannot say that the production loss sustained during those short periods would not have been compensated for in other months and the average earning rate generally sustained throughout the period in question. Moreover,

if the partners had complied with their contract, there would have been a sufficient inventory at the mill to carry it through such periods.

(e) Appellants assert that Exhibits 19a, 19b, 19c and 22 are insufficient to sustain the finding of damages because they do not show that the transfers within Buffelen's organization were at the market price (McK. Br., pp. 26-27); yet, they were shown to have been prepared from the company's books by its regular accountant (Tr., pp. 200-201, 202, 475). Their accuracy is not questioned. The transfers of lumber to all purchasers are reported as actual sales at specified prices. Finally, no mention was made of this alleged omission at the trial. It is an afterthought, and in the absence of anything to impeach the records either as to their form or contents, they stand as convincing evidence of the actual profits and losses reported therein to have been earned and incurred.

II.

Exhibits 19a, 19b and 19c were properly received by the trial court, and appellants' objection thereto is not well taken (Specification of Error III).

SUMMARY

A. Counsel did not call the attention of the court to the objection now relied upon.

B. In the absence of any proper objection, the court did not err in admitting the exhibits.

C. The exhibits were properly admitted regardless of such objection.

D. Counsel waived any objection to the admission of the exhibits on the ground that the primary books of account were not present in court.

Counsel specified the grounds for his objection to these exhibits at the trial (Tr., pp. 201-203), and the reasons there stated relate only to the question of materiality. Counsel argued (a) that profit and loss statements could not constitute the measure of damages and (b) that the records covered a period not in controversy.

It has already been shown (supra, p. 16) that the rule in Oregon is contrary to these assertions. Records of past earnings are an approved method of establishing damages caused to an established business by breach of contract, and these exhibits show the amount of those earnings.

Nowhere did counsel direct the Court's attention to the objection now asserted, that these exhibits were incompetent in the absence of testimony that the sales reported therein to other units of Buffelen's organization were made at the market price (McK. Br., p. 32). This, in effect, is an objection to the absence of testimony that the books from which the exhibits were prepared were kept according to standard bookkeeping practices. No opportunity was provided at the trial to examine the point or, if necessary, correct it. The law is conclusive that counsel is limited to the objection urged before the trial court, and the present objection cannot now be considered. A similar situation arose in *Employers Mutual Casualty Co. vs. Johnson*, 201 F.2d 153 (C.A. 5 1953), which was a proceeding under the workmen's compensation law of Texas. Certain x-ray films were received in evidence, and on appeal it was contended that they were inadmissible in the absence of preliminary evidence that they had been taken in accordance with "recognized standards." At the trial, however, appellant had challenged only the competency of the witness to interpret films which he himself had not taken. Judgment was affirmed in the following language.

> "* * * When an objection is made to the introduction of evidence, the grounds therefor must be clearly and specifically stated for the benefit of

> the court and opposing counsel in order that the objection, if sustained, may be cured by additional evidence. In the event that error was committed, the appellant waived its right on appeal because of failure to object at the trial and to state the basis on which the objection was made. * * *" (At pp. 155-156)

See also *Norwood vs. Great American Indemnity Co.*, 146 F.2d 797 at p. 800 (C.C.A. 3 1944); *Tucker vs. Loew's Theater & Realty Corp.*, 149 F.2d 677 at pp. 679-680 (C.C.A. 2 1945); *Collins vs. Streitz*, 95 F.2d 430 at p. 437 (C.C.A. 9 1938). In *Maulding vs. Louisville & N. R. Co.*, 168 F.2d 880 (C.C.A. 7 1948) it was said:

> "It is not permissible to so frame an objection that it will serve to save an exception for the action of a court of review and yet conceal the real complaint from the trial court." (At p. 882)

Counsel has cited no authority and we have found none requiring such preliminary testimony. There is no question that the summaries, prepared from books kept under the supervision of the witness (Tr., pp. 200-201, 202), were admissible, *Thompson vs. Arthur L. Hardin Associates*, 219 S.W.2d 860 (Mo. 1949); *Batterson vs. Am. Stores Co.*, 367 Pa. 193 at pp. 206-

208, 80 Atl.2d 66 (1951); 4 Wigmore on Evidence 434 (§1230). Counsel does not assert that they were inadmissible if there had been such evidence, and in the absence of any objection or offer of evidence to the contrary the exhibits must be taken to establish the profit therein stated to have been earned. No reason is suggested for selling the mill's production at any price other than the market, and there is nothing to suggest that any other price was used. The Specification is groundless.

Included in the Specification but ignored in the argument thereon is a colloquy between the court and counsel regarding appellee's failure to have its primary books present in court. It is wholly uncertain whether or not the court's failure to strike the exhibits of its own motion is assigned as error. There was preliminary testimony that the exhibits had been prepared directly from the underlying books (Tr., pp. 200-201), and their accuracy is not questioned. In any event, *no objection was entered nor was any motion made to strike the exhibits from the record.* The underlying books need not always be present, and any objection based thereon was waived. *Burton vs. Driggs*, 87 U.S. 125 at pp. 135-136, 22 L. Ed. 299 (1873).

Finally, appellants not having argued the matter, this part of the Specification was waived.

III.

The trial court applied the correct measure of damages, and appellants' objection thereto is not well taken (Specification of Error IV).

SUMMARY

A. The court properly awarded damages for lost earnings.

Appellants contend that Buffelen can recover no more than the difference between the market price and the contract price of logs, although they admit that if there were no alternative log supply lost earnings could be recovered. (*Norwood vs. McLean*, 153 F.2d 753 at p. 757 (C.C.A. 3 1946); McK. Br., p. 40). This contention is without merit.

The evidence is overwhelming that there was no alternative supply of logs for the mill (Tr., pp. 129, 135, 139, 218-222, 464-475). The only suggestion to the contrary was the interested testimony of appellant Bart McKenney (Tr., pp. 301-302), and the trial court's resolution of this conflicting evidence will not be disturbed.

It is suggested that the general availability of logs at Batterson is "common knowledge" (McK. Br., pp.

28, 35, 40). No circumstances supporting this astonishing contention are set forth, and the record conclusively demonstrates that it is untrue. At the very least, the evidence presented a question for the determination of the trial court. In *Norwood vs. McLean*, supra, 153 F.2d 753 at p. 756 (C.C.A. 3 1946) evidence much weaker than that developed here was held to present a jury question. The circumstances of this case conclusively disprove any presumption that other logs were available. It follows that appellee is not limited to price differences, but may instead recover lost earnings. See *Martin vs. Neer*, 126 Ore. 345 at pp. 353-357, 269 Pac. 342 (1928); *Outcault Adv. Co. vs. Citizen's Nat'l. Bank*, 118 Kans. 328 at p. 330, 234 Pac. 988 (1925).

IV.

The trial court properly entered judgment against the partnership for the value of timber cut and removed from appellee's land by the corporation (Specification of Error V).

SUMMARY

A. Appellants are liable for having caused the trespass, and they do not deny it.

B. Appellants are not entitled to an offset for sums they would have been entitled to receive if they had cut and delivered the logs.

Appellants assert that they are not liable for the value of timber converted by the corporation, because they were entitled to received that value if they performed their contract and logged and delivered the timbr to Buffelen (McK. Br., pp. 41-43).

Appellants were not held liable as original trespassers. They are liable for having caused the trespass by attempting, contrary to the express terms of the contract (Tr., pp. 134-135), to sell timber standing in Buffelen's name and subject to the contract and delivering possession thereof to the corporation, thereby enabling the corporation to trespass against and convert the timber. The trespass was the normal and proximate result of the attempted conveyance, and the partners are liable for the resulting damage. See *Lepla vs. Rogers* [1893] 1 Q.B. 31; 127 A.L.R. 1016; L.R.A. 1918D 220; 34 Am. Jur. 566 (Logs and Timber, §116); 3 Sutherland on Damages (4th Ed., 1916) 3170-3174 (§861). *They do not deny this liability or question the finding that the logs removed were worth $50,000.00.*

Under the contract, appellants were entitled to cut and deliver logs; they were also entitled to a conveyance of logged-off land at a nominal price (Tr., pp. 132, 133). The McKenneys could never earn their money on logs removed by the corporation. They were

not entitled to be paid for it, and thus have no offset to assert against the liability which they do not deny. In *Springer vs. Jenkins*, 47 Ore. 502, 84 Pac. 479 (1906), a mortgagor sued his mortgagee for conversion. The mortgagee pleaded the mortgage and contended plaintiff could recover only the residual value. The plea was held subject to demurrer, and the court said:

> "* * * the answer does not contain facts sufficient to constitute such a defense. *It is not alleged that the defendants were the owners of the mortgage debt at the time of the alleged conversion* * * *" (Emphasis supplied.) (At p. 507)

Cf. *Pedro vs. Vey*, supra, 150 Ore. 415 at pp. 430-432, 39 P.2d 963, 46 P.2d 582 (1935).

Appellants cannot and do not contend that they were entitled to anything for timber removed by the corporation and sold to third persons. They do not deny that the timber stood in Buffelen's name. Under the contract, they had no interest in it or right to its proceeds until they performed the contract. Having breached the contract, the contention that they are entitled to an offset is without merit.

This recovery is in no way duplicitous. Having caused the trespass by their own wilful act, appellants are liable for the resulting damage. This liability is separate and apart from that incurred for failure to

cut and deliver logs to Batterson, which is measured by lost earnings, not the value of the stolen timber.

V.

The trial court did not err in rejecting "Pre-trial Exhibit 24," and appellants' objection thereto is not well taken (Specification of Error VI).

SUMMARY

A. Specification of Error VI is fatally defective.

B. Counsel did not ask that the trial court receive the evidence.

C. The reception of newly-discovered evidence is discretionary with the trial court, and appellants do not contend that the trial court abused its discretion.

D. Appellants did not show that they had exercised due diligence in discovering the proposed exhibit.

As pointed out above, Specification VI is fatally defective, because it does not set forth the full substance of the rejected evidence and the grounds urged for its admission at the trial as required by Rule 20 (2) (d) (supra, p. 3). In any event, counsel specifically stated at the hearing that he did not desire the case to be reopened to admit the exhibit (Tr., p. 554).

Furthermore, the reception of newly-discovered evidence following trial is discretionary with the trial court, and there are no circumstances whatever indicating that the court abused its discretion in refusing to admit the exhibit, which was offered June 8, 1953, six (6) months after the second trial and seventeen (17) months after the original trial of the case. Counsel does not assert that the trial court abused its discretion in rejecting the exhibit (McK. Br., pp. 43-44). *See Gerson vs. Anderson-Pritchard Production Corp.*, 149 F.2d 444 at pp. 446-447 (C.C.A. 10 1945); *Johnson vs. Cooper*, 172 F.2d 937 at p. 941 (C.A. 8 1949); 4 Cyc. Fed. Proc. 71-77 (§34.05).

Finally, appellants did not show that they exercised due diligence in locating the exhibit, which was a purported earlier contract signed by them but never before referred to. *Grant County Deposit Bank vs. Greene*, 200 F.2d 835 at p. 841 (C.C.A. 6 1952); *Raske vs. Raske*, 92 Fed. Supp. 348 at p. 350 (D.C. Minn. 1950).

The court did not err in rejecting the exhibit.

In any event, the earlier contract would be superseded by a later and inconsistent contract and would not assist in any way in the construction of the latter (A.L.I. Restatement of the Laws of Contracts §408). It is not suggested that the contract of January 8, 1948

was merely an integration of the earlier contract; it specifically states that the only agreements still existing and being integrated therein are oral agreements (Tr., p. 129). The earlier agreement is therefore not admissible to construe its terms (A.L.I. Restatement §238).

CONCLUSION

Appellants have taken an extraordinary position. Having committed a wilful and deliberate breach of contract with full knowledge that it would destroy a large capital investment and cause appellee heavy operating losses, they now assert in effect that they should be relieved of liability because there is insufficient evidence of the precise amount of the damages caused by the breach. That they caused damage is not actually contested; only the amount is considered excessive (see Specifications of Error I, II, IV).

The type of loss sought to be recovered is seldom susceptible of exact proof, but the proof in this record is wholly sufficient to show both the fact and the amount of damage. It was the only available evidence and entirely supports the findings of the trial court.

The law does not require the impossible, nor does it permit wrongdoers the benefit of every doubt. It

requires primary proof of injury, and the record proves conclusively that Buffelen was injured. It lost 2,000,000 feet of its timber supply worth $50,000.00, and in place of a profit of $7,500.00 per month it sustained net losses in eleven (11) months in excess of $30,000.00. Buffelen's operation at Batterson was delayed and restricted by lack of logs which it was appellants' obligation to supply. There was no alternative log supply and Buffelen sustained heavy losses. Its experience in this regard was identical with that of Roy Gould, who operated the mill for a short time.

There being a conclusive showing of injury, the remaining question is whether, under the liberal Oregon rule, there was sufficient evidence of the amount thereof. Consistently with the Oregon rule, past earnings and actual operating losses were shown, together with the value of the converted timber. It was shown that two employees devoted their time to the job of attempting to minimize those losses. Substantial evidence was offered of improved market conditions. This evidence was not contradicted in any manner, and fully supports the trial court in the amount of its award.

As was said in 53 L.R.A. 33 at pp. 71-72:

> "The profits to be derived by the lumberman from logging and lumber contracts are not only

proximate and direct, but also peculiarly certain owing to the facility and accuracy with which the cost of execution may be estimated."

The evidence is not only substantial and sufficient to support the court's findings; it is conclusive that the damages awarded were proper in amount. The appeal of appellants Bart and Marie McKenney, seeking a third trial of this case, must be dismissed and the Judgment and Decree of the trial court affirmed.

Respectfully submitted,

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No. 14188

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

REPLY BRIEF OF APPELLANTS BART McKENNEY and MARIE McKENNEY, individually and as co-partners in McKenney Logging Company

Appeals from the United States District Court for the District of Oregon.

HONORABLE JAMES ALGER FEE, Chief Judge.

THEODORE B. JENSEN,
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Appeals from the United States District Court for the District of Oregon.

HONORABLE JAMES ALGER FEE, Chief Judge.

A. ON APPELLEE'S PRELIMINARY STATEMENT OF THE CASE

As stated by Appellee further briefs will be filed in this case by the other Appellants. Since the judgment and decree is jointly against the other Appellants, Einar Glaser and Dorothy Glaser, and these Appellants, Bart

McKenney and Marie McKenney, the Appellee has no claim, if there be any, to waiver on Specifications VII to XIII inclusive, until after the remaining briefs have been filed. It may be anticipated that all of the Specifications of Error in Appellants McKenneys' brief with others will be amply argued and supported by authorities, and any objections now urged against Specifications VI and XIII by the Appellees be removed in such further and later briefs.

B. ON APPELLEE'S CORRECTION OF McKENNEYS' STATEMENT OF THE CASE

The apparent typographical error in the amount on page 8 of our opening brief to which the Appellee calls attention is by such correction now rightly stated to be $2,409,991.88 as the amount Buffelen paid the partners in the purchase from the partners of 55,546,171 feet of logs under the contract January 8, 1948, Exhibit 1.

With respect to Appellee's statement on page 4 of its brief, that "The partners, however, prepaid these stumpage charges in the course of their earlier deliveries," we perceive in such attempted correction to McKenney's Statement of the Case, some possible hint of a difference between "prepayment of stumpage charges" and the statements of Appellants McKenneys' that payment was made in full by the partnership for the timber standing in the name of Buffelen.

Since this Appellant had pointed out repeatedly in its opening brief (p. 12 of McK. Brief and at other pages) that an admitted fact in the case was that "the

partnership had repaid the Lumber Company, Buffelen, all of its advances, including Buffelen's advances for purchase of timber lands and cutting rights covered by the contract (Exhibit 1, Pragraph IV, Pre-Trial Order, Agreed Facts, Tr. 16) and since the Appellee is confronted with a factual situation where the partnership gets all of the money for timber cut from such lands, (including the lands standing in the name of Buffelen) whether Buffelen purchase such timber or not, it is understandable that Appellee may seek for more convenient words of expression. The unyielding and relentless fact is that the McKenney partnership had bought and paid for all of the timber covered by Exhibit 1, which is the contract of January 8th, 1948 as supplemented.

Appellee asserts (p. 5 Appellee's Brief) "The McKenneys do not deny liability for the corporation's acts." Appellants McKenney most certainly do and assert that they cannot be held liable for the acts of the McKenney Logging Corporation.

ON APPELLEE'S ANSWERS TO SPECIFICATIONS OF ERROR I AND II

Counsel attempts persistently by argument to expand the precise language on the face of Exhibits 19a, 19b, and 19c. On page 8 of its brief by the device of tying-in Exhibit 22 in the same sequence as Exhibits 19a, 19b, and 19c, seeks to gain benefit for Exhibits 19a, 19b, and 19c, from the testimony of witness Miles when Exhibit 22 was admitted to which Appellee is not en-

titled. There is not a syllable of testimony concerning Exhibits 19a, b and c, on page 462 of the Transcript, and yet the first sentence on page 8 of Appellee's brief reads as follows:

> "EXHIBITS 19a, 19b, 19c and 22 were prepared directly from the books of the company to show the financial performance of the mill from July 1, 1948 to October 31, 1952 (Tr. pp. 200-201, 462). They show average monthly earnings of $9,000.00 during the fiscal year ending June 30, 1950 and $6,000 in the following year. They are based upon the amount of actual operating time and accurately report costs incurred in the operation of the mill (Tr. pp. 481-482)."

There is not a syllable of testimony with respect to Exhibits 19a, 19b, and 19c, on pages 481-482 of the Transcript of Record.

The plain fact is that Exhibits 19a, 19b, and 19c stand by themselves without any aid from witness Miles testimony when they were admitted. Such testimony is reported on pages 200-205 of the transcript and there is no other or additional testimony with respect to Exhibits 19a, 19b, and 19c. We said in our opening brief that witness Miles' testimony added nothing to the documents themselves and this has not ben controverted.

We stress the matter here for our Specification of Error No. 1 presents an irreparable defect in Appellee's case. The defect is a glaring omission and has been created by an attempt by Appellee to prove loss of profits in a tremendous amount by the introduction of Exhibits (19a, 19b, and 19c) as SUBSTANTIVE EVIDENCE which exhibits are wholly inadequate and

the inadequacy thereof is apparent on the face of such exhibits. It is a trial error of omission and leaves the Appellee without any evidence on the most important and crucial point in the whole part of the case pertaining to loss of profits.

Counsel for Appellee seeks by the methods in its brief we have hereinabove revealed to avoid the catastrophy which now surrounds them arising out of the situation produced as we have just stated. We find on page 24 of Appellee's brief: with respect to Exhibits 19a, 19b, 19c, the same tie-in for in sequence again we find "and 22". The vehicle has been so provided for this statement "The transfers of lumber to all purchasers are reported as actual sales at specified prices." Where is the evidence to support that statement with respect to Exhibits 19a, b, and c? There is nothing on Exhibits 19b and 19c to show that any transfers were reported as actual sales at specified prices. As stated in our opening brief, sales as shown by Exhibit 19b say "Sold to Others," 3,850,380 feet of lumber at $32.55 per thousand which cost $46.92 to produce and Exhibit 19c likewise shows "Sold to Others," 2,841,893 feet of lumber at $31.31 per thousand which cost $47.55 to produce. But not a word appears therein as sales of the rest of the millions of feet of lumber.

Exhibits 19b and 19c (these two are relied upon to support use value by the Appellee, for Exhibit 19a shows a loss) state that large quantities of lumber were transferred to Hardwood-Tacoma; Door Factory-Tacoma and Sawmill-Tacoma, at $160; $79.23 and $28.96 re-

spectively, and on 19b and at $19.86; 119.08 respectively and to PM No. 3 Tacoma at $100.

We query, how could such transfers be sales? Buffelen would thereby be making sales to themselves, which of course, is an utter impossibility. And if Buffelen had made sales to subsidiaries, which is not claimed, it is submitted that the statements of counsel could not even then take the place of testimony that market prices were used in making up the Batterson Cost Reports Exhibits 19a, 19b, and 19c.

On page 28 of Appellee's brief counsel persists in calling the transfers, sales. It is there stated: "No reason is suggested for selling the mill's production at any price other than the market, and there is nothing to suggest that any other price was used." The fact is as above stated there were no sales of any lumber except that stated "Sold to others" on the exhibits 19a, b, and c. and such sales according to the exhibits were at a substantial loss.

Where is the proof that the Batterson Mill ever made a profit? It is so obvious that Exhibit 22 can be of no avail to plaintiff until plaintiff has first shown that the Batterson Mill made a profit, that the mere mention of it here may appear superfluous. Appellees' theory of use value is wholly dependent upon past performance. The Oregon Supreme Court says "actual past profits" in *Williams v. Island Milling Co.* cited by Appellee in its brief at page 17. We think it might be well to interpolate a part of the omitted portion which omission has been appropriately and duly indicated by asterisks in quoted

portion of *Williams v. Island Milling Co.* in Appellee's brief:

> "Under the rule adopted by the trial court, however, the damages were to be determined on an estimate of the future profits the defendant might have realized from a sale of the mill products, had the mill been operated to its full guaranteed capacity, basing the same upon a net profit of seventy-five cents per barrel of flour, without regard to what the past experience of the defendant had shown the actual value of the use of the property to be, and was, we think, therefore, too speculative and uncertain to form a basis for estimating damages, when other and more certain data were on hand. (citations omitted by us)."

For purpose of brevity we have omitted as above stated a portion of the part which was omitted by Appellee in its quotation from the case.

All claims made by Appellee for the testimony of their witness and co-adventurer Gould in its answering brief have been decided against Appellee by the Oregon Supreme Court in *Randles v. Nickum & Kelly Sand & Gravel Co.*, 169 Or. 284, 127 P. 2d 347, discussed at some length in our brief (pp. 20-21).

REPLYING TO APPELLEE'S ANSWERS ON RECOVERY OF EARNINGS LOST

First we wish to show that the Oregon rule in this regard is not contrary to that set forth by the Supreme Court of Washington in *National School Studios, Inc. v. Superior School Photo Service, Inc.*, 40 Wash 2d 263, 242 P. 2d 756 (1952), discussed in our opening brief at

page 22. It should be noted that the most recent Oregon case discussed or cited by Appellee in its brief on this point is 149 Ore. 388, at page 14 of Appellee's brief. Since then we find *Stubblefield v. Montgomery Ward & Co.,* 163 Or. 432, 96 P. 2d 774, 98 P. 2d 14 (1940), and others including the rather recent case of *Carlson v. Steiner,* 189 Or. 256, 220 P. 2d 100 (1950). In the Washington case, *National Studios, inc. v. Superior School Photo Service, Inc.,* supra, the Court among other authorities cites (at page 763 of 242 P. 2d) the Restatement, Law of Contracts, 515, Sec 331, in support of the trial court's view, which view we discussed at page 22 of our brief.

The Oregon Supreme Court speaking through Mr. Justice Rossman in *Stubblefield v. Montgomery Ward & Co.,* supra, said (at page 780 of 96 P. 2d) (we quote only in part):

> "The measure to be employed in determining the amount of the consequential damages in this case is well established, we believe. From Restatement of the Law, Contracts, Section 331, we quote: 'Damages are recoverable for losses caused or for profits and other gains prevented by breach only to the extent that the evidence affords a sufficient basis for estimating their amount in money with reasonable certainty.' The plaintiffs do not ask that the consequential damages be measured by the anticipated profits of the hotel, and hence we shall pass on to the next paragraph of Section 331, which states the measure to be employed where the profit yardstick is not available; but before passing on we pause to observe again that the evidence must afford 'A SUFFICIENT BASIS FOR ESTIMATING' the amount of damages * * *." (Capitalization ours).

Mr. Justice Rossman also discusses at page 781, *Williams v. Island City Milling Co.,* 25 Or. 573, 37 P. 49, which is one of the cases relied upon by Appellee.

In *Carlson v. Steiner,* supra, Mr. Justice Brand speaking for the Oregon Supreme Court quotes the same portion of Section 331 of Restatement of Contracts which Mr. Justice Rossman quoted in *Stubblefield v. Montgomery Ward & Co.,* supra, which we have hereinabove set out, and at page 104 of 220 P. 2d says (we quote only in part) with reference to said Section 331:

> "The rule thus stated is cited with approval in Stubblefield et al. v. Montgomery Ward & Co.,, et al., 163 Or. 432, 96 P. 2d 774, 98 P. 2d 14, 125 A.L.R. 1228, 1240, and see Beisell, et ux. v. Wood, et ux., 182 Or. 66, 185 P. 2d 570. We have no doubt concerning the correctness of the Stubblefield decision, but the issues thereof do not resemble those in the case at bar. * * *"

The Oregon Court then discusses the other portions of Section 331 of the Restatement and quotes from the section thereof affording greater leeway in certain cases, and discusses, or at least cites, most of the cases cited on this point by Appellees; and also cites *Randles, et al. v. Nickum & Kelley Sand & Gravel Co.,* 169 Or. 284, discussed in Appellant McKenney's brief. Mr. Justice Brand in *Carlson v. Steiner* after stating that the defendant argued that the plaintiff suffered no damage, or if damage was suffered, that the evidence thereof was too uncertain to permit of assessment in money, observed in part (p. 104 at 220 P. 2d):

> "If the question were properly before us, it would present a difficult problem because the case conceededly rests close to the borderline. * * *"

The defendants, appellants, having attempted to raise the objection concerning the speculative character of the damages awarded to the effect that the judgment was not supported by the evidence, and not having raised the question in the manner required by Oregon statute, which requires objection to findings of fact or the request for other findings in a case tried by the court, Mr. Justice Brand held that the question as to the alleged speculative character of the damages or the measure thereof was not before the court for review. The court cited among other cases the recent case of *Beisell v. Wood,* 182 Or. 66, 185 P. 2d 570. We read in that case the following statement by Mr. Justice Hay (at page 574, 185 P. 2d):

> "Assuming, without deciding, that evidence of loss of time and expense involved in this connection was admissible under the allegations of general damages, we are of the opinion that the evidence offered will not support an award of damages. While the inconvenience was no doubt considerable, there was no proof whatever of the time consumed or the expense involved, or of the value thereof in terms of money, factors which were essential to enable the court to make an award of monetary compensation therefor. As a general rule, compensation in money must be fixed according to some standard which will admeasure the loss in terms of pecuniary value, *if this can be done, and the measure applied must be a real and tangible one.*" (Italics ours, and we have omitted citations.)

The court continued:

> "We think that the value of the time consumed and expenses involved herein were matters that were susceptible of proof within a reasonable degree of

> certainty. The court cannot base an award of damages upon mere speculation, conjecture, or surmise. (citations again omitted). Under the circumstances, nominal damages only may be awarded." (Citations omitted.)

In view of all of the foregoing by the Oregon Supreme Court can it be said that the Washington rule is less liberal than the Oregon rule, or as Appellee has asserted that the Oregon rule in "this regard" is contrary to the Washington case we have cited. Appellee would have this Court believe that the Washington rule requires exact proof. The Washington rule requires the same as the Oregon rule, and that is an award of damages cannot be based upon mere speculation, conjecture, or surmise. *Pedro v. Vey,* 150 Or. 415, cited by Appellee is not to the contrary.

The finding in the instant case is clearly erroneous. Both an obvious error of law and a mistake of fact has been made by the District Court. There is no substantial evidence to support the finding of $118,000 loss of profits. *U. S. v. U. S. Gypsum Co.,* 333 U.S. 364 at p. 394, 68 S. Ct. 525, 92 L. Ed. 746 (1948).

We might point out here that Appellee in (d) on page 23 of its brief, refers to Exhibits 19a, 19b, and 19c in connection with Average monthly earnings and in E, on page 19 of its brief, say that the use value of the mill for 11 months (December 1,1951 - October 31, 1952), calculated from the same exhibits was $82,500.00.

For the sake of accuracy let us now refer to—

Exhibit 19a, which on its face allegedly states Book Loss	$ 6,132.62
Exhibit 19b, which on its face allegedly states Book Profit	113,309.75
Exhibit 19c, which on its face allegedly states Book Profit	100,229.57
	$207,406.70
The average monthly sum for the 36 month period covered by Exhibits 19a, b, and c is	$ 5,761.00

We assume that Appellee has divided the sum of $113,309,75 from Exhibit 19b plus the sum of $100,-229.57 from Exhibit 19c by 24 and thereby arrived at $82,500.00 for the eleven month period. But $113,309.75 plus $100,229.57 divided by 24 and multiplied by eleven does not produce $82,500.00 but does result in a sum of $97,112.00.

Since Appellee states that Exhibits 19a, 19b, and 19c, and 22 are wholly sufficient and convincing to support the finding of the trial court, we suggest that Appellee explain why the court has not taken the 36 month period as we have indicated above, so that the 11 month period for which Appellee gets an arithmetical result of $82,500.00 should not have been stated as 11 x $5,761 or $63,371.00. Thereby it would seem that by adding the alleged loss of $30,533 to $63,371 which totals $93,904, and taking the $93,904 from the $118,000, there would have been left $24,906, a much more tidy sum to be made up in the manner Appellee's counsel has done by grasping in the record for the fact that Buffelen had a couple of scouts reconnoitering the great forests of Tillamook County, Oregon in an attempt to find #2 Fir Saw logs.

The foregoing we submit presents a graphic picture of what happens when the field of speculation, conjecture and surmise is entered upon to support a judgment of $118,000 for loss of profits. Appellee states to this Court in its brief at page 19, that the exhibits are wholly sufficient and convincing evidence to support the finding of the trial court and then proceeds to attempt by arithmetic to show that it is so, which of course, it has not done as we have so clearly demonstrated by the foregoing. We say that the Exhibits 19a, 19b and 19c prove nothing in the case. Borrowing from the language of wisdom of the Oregon Supreme Court in the loss of profits cases, *Randles v. Nickum & Kelley Sand & Gravel Co.,* it may be safely said that to sanction the recovery for damages in this case for loss of profits for which there is no firmer foundation than was provided here would be practically to remove all the safeguards which the law has wisely thrown around claims of this character.

REPLYING TO SECTION IV OF APPELLEE'S BRIEF ENTITLED "THE COURT PROPERLY ENTERED JUDGMENT AGAINST THE PARTNERSHIP FOR THE VALUE OF TIMBER CUT AND REMOVED FROM APPELLEE'S LAND BY THE CORPORATION (SPECIFICATION OF ERROR V)

To the assertion by the Appellee that Appellants McKenney cannot and do not contend that they were entitled to anything for timber removed by the corporation

and sold to third persons, we suppose that Appellee wants to have this Court conclude that if Appellants McKenney reply that they have the right to collect the $50,000 from the corporation, then the partnership is out nothing, if and when it collects that sum from the corporation. But in our opening brief we asserted time and again that regardless of whether Buffelen bought the logs or not, the partnership would get $50,000 for the stumpage. Clearly the Corporation was and is liable to the partnership for the market value of the stumpage, which it has been testified is worth $50,000. It is undisputed that all of the stumpage standing in Buffelen's name has been paid for by the McKenney partnership.

The McKenney partnership can and does contend that they are entitled to the $50,000.

CONCLUSION

We do not understand what Appellee claims for the citation to 53 L.R.A. 33, at pp. 71-72, in the conclusion of its brief. The purpose thereof was not stated.

The judgment and decree herein should be reversed and a new trial granted.

Respectfully submitted,

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Bart McKenney and Marie McKenney.

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BRIEF OF APPELLANT McKENNEY LOGGING CORPORATION

Appeals from the United States District Court for the District of Oregon.

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Appeals from the United States District Court for the District of Oregon.

To avoid repetition, Appellant McKenney Logging Corporation adopts the "Jurisdictional Statement"; the "Statement of the Case"; the "Specifications of Errors";

the "Statement of Facts"; and the "Arguments" in the brief of the Appellants Einar Glaser and Dorothy Glaser, and the arguments on the questions of damages in the brief of Appellants Bart McKenney and Marie McKenney.

This brief, therefore, will be confined to the specifications of error affecting Appellant McKenney Logging Corporation alone.

In this brief, the parties will be referred to, the same as in the brief of Appellants Einar Glaser and Dorothy Glaser, to-wit:

Buffelen Manufacturing Co., Appellee, will be referred to as the "Lumber Company"; McKenney and Glaser as the "Logging Company"; and McKenney Logging Corporation as the "Corporation".

POINT I

The Court below erred in holding that McKenney Logging Corporation unlawfully interferred with and induced the Logging Company to breach its contract with the Lumber Company. The mere knowledge of the contract between the Lumber Company and the Logging Company does not constitute inducement to breach the contract.

Summary of the Argument

A.

There is no substantial, or even a scintilla of, evidence that the Corporation committed any affirmative act constituting coercion or inducement of the Logging Company to breach its contract with the Lumber Company.

B.

The mere fact, if it be a fact, that the Corporation had knowledge, actual or constructive, of the existence of the contract between the Lumber Company and the Logging Company, does not constitute coercion or inducement of the Logging Company to breach the contract.

Re Statement of the Law of Torts, Section 766, Comment (i);

Sweeney v. Smith, 167 Fed. 385, Aff'd 171 Fed. 645 (Third Cir.), Certiorari denied, 215 U.S., 600;

United States v. Newbury Mfg. Co., 36 F. Supp., 602 (D.C. Mass).;

Lamport v. 4175 Broadway, Inc., 6 F. Supp. 923;

30 Am. Jur., 75 (Title: Interference);

Caldwell v. Gem Packing Co., 125 P. 2d 901, 904;

Horth v. American Aggregates Corporation, 35 N.E. 2d 592, 597, 598;

Pestel Milk Co. v. Model Dairy Products Co., 52 N.E. 2d 651, 658;

Kelly v. Central Hanover Bank & Trust Co., 11 F. Supp. 497.

C.

The evidence establishes affirmatively that the Appellant Corporation did not seek out the Logging Company in connection with the purchase of the timber lands from the Logging Company. On the contrary, the Logging Company's Agents sought the Corporation and induced the Corporation to purchase the same from the Logging Company. The Corporation was merely a willing buyer of the timber lands and contracts.

Argument

The liability sought to be imposed on the Corporation is in *tort* and not for breach of contract.

Unlawfully inducing a breach of a contract without justification, is recognized only as a tort. It does not create a cause of action for breach of contract.

The *pre-trial* order in this case (Tr. 10, I), which "supersedes the pleadings which are now dispensed with" merely alleges in this respect (Tr. 14, VI) that Plaintiff contends that

> "Defendant McKenney Logging Corporation is liable to plaintiff . . . . . for interfering with the contract between plaintiff and defendants McKenney and Glaser and inducing a breach thereof."

There is no statement anywhere in *Plaintiff's contentions,* or in the *tendered issues* of fact, that the Corporation committed any specific act, or acts, which would constitute, in legal contemplation, inducement or coercion of the Logging Company to breach its contract with the Lumber Company, such as threats of boycott, or any other threat, or the offering of any consideration for the timber lands greater than that offered by the Lumber Company, or the like, or any other inducement.

The *findings of fact* do not recite or set forth the commission of any affirmative act by the Corporation which would constitute coercion or inducement. The only pertinent statements in the findings of facts (Tr. 84-90) are that the Corporation

"had knowledge of the contract," (Tr. 88, XI) . . . . .

and that

> "Plaintiff sustained damages . . . . . by reason of McKenney Logging Corporation's interference with and induring defendants McKenney and Glaser to breach the contract . . . . . " (Tr. 89, XIII).

This is not actually a finding of fact. It is merely a conclusion and is repeated in the conclusions of law (Tr. 93, XII), that

> "Corporation is liable to plaintiff . . . . for interfering with the contract . . . . . and for inducing a breach thereof."

The Corporation was held liable in tort for inducing the Lumber Company to breach the contract with the Lumber Company and damages were assessed against the Corporation (a) $50,000.00 (trebled by the judgment) for the value of timber allegedly removed by the Corporation from the timber lands described in that contract, on the theory that it was a trespasser, and (b) $118,000.00 for loss of profits resulting from the failure to sell logs for the operation of the Batterson Mill.

If the Corporation did not commit the tort of unlawfully inducing the Logging Company to breach the contract, it cannot be held liable in any event for either of the elements of damages assessed against it.

If the conclusory statement in the finding, referred to above, is deemed to be a finding of fact of inducement, we submit that there is no substantial evidence in the record, or even a scintilla of evidence, of any act on the part of the Corporation which constitutes inducement or coercion which caused the Logging Company to breach its contract

with the Lumber Company, assuming, without admitting, that it did so.

The subject matter of the contract between the Lumber Company and the Logging Company was not the sale of timber lands and timber contracts by the Logging Company to the Lumber Company. That contract had two aspects:

(a) The transfer of title to the timber lands and contracts to the Lumber Company as security for loans; and

(b) An option from the Logging Company to the Lumber Company to purchase logs after they are cut from the said timber lands.

The transaction between the Logging Company and the Corporation consisted of a sale of the timber lands and timber contracts from the Logging Company to the Corporation.

The transaction between the Corporation and the Logging Company was not initiated by the Corporation. It did not seek out the Logging Company.

The record establishes beyond question that the Logging Company was eager to dispose of its holdings and get out of the logging operation. McKenney testified:

> "A. Well, Mr. Holm knew that I wanted to sell; that I wanted to liquidate my—dissolve our partnership."

To that end, it first employed a broker named Kerr (Tr. 442). This broker negotiated a sale of the Logging Company's interests in the timber lands to Portland Manufacturing Company (Tr. 442). The contract was

made and earnest money was put up, but the transaction was rescinded because of the Lumber Company's refusal to consent to the transfer. Bart McKenney then interested Matott, Appellee's witness, in procuring a purchaser. Matott introduced McKenney to Mr. Errion, a broker who was engaged by the Logging Company to find a purchaser (Tr. 394), and he was given a listing by the Logging Company for the sale of the property (Tr. 406, 440). Errion introduced Buol and Carr (Corporation) to the Logging Company (McKenney and Glaser) and they then negotiated for the sale of the timber lands by the Logging Company to the Corporation.

There is evidence in the record (denied by Buol and Carr) to the effect that Buol and Carr (Corporation) were told, during the negotiations, about the contract between the Logging Company and the Lumber Company and that they saw a copy of it.

This is the sum total of the evidence as to what transpired between the parties, which resulted in the sale of the timber lands by the Logging Company to the Corporation. There is not one word of testimony of the commission of any affirmative act establishing, or tending to establish, that the Corporation coerced or induced the Logging Company to sell to the Corporation the timber lands and timber contracts. The Logging Company through its agents solicited the Corporation to purchase the property.

It is settled law that the mere knowledge of the existence of the contract does not constitute coercion or inducement.

Section 766 of the Restatement of Law of Torts, comment (i), says:

> "MAKING AGREEMENT WITH KNOWLEDGE OF THE BREACH. One does not induce another to commit a breach of contract with a third person under the rule stated in this section when he merely enters into an agreement with the other with knowledge that the other cannot perform both it and his contract with the third person. (Compare comment (h)). For instance, B. is under contract to sell goods to C. He offers to sell them to A who knows of the contract. A accepts the offer and receives the goods. A has not induced the breach and is not subject to liability under the rule stated in this section."

In *Kelly v. Central Hanover Bank & Trust Co.,* 11 F. Supp., 497 (U.S.D.C., S.D. New York), Judge Mack held:

> "They seek to have the court create a liability in equity, based on a knowing participation in, though not the inducing of a breach of contract when, for that breach, the remedy at law against the promisor is inadequate, because of its insolvency, actual or highly probable. Such *noninducing interference or participation* by the third party *is not actionable at law as a tort* (citing cases)." (Emphasis supplied.)

In *Sweeney v. Smith,* 167 Fed. 385 (C.C. Pa.), aff'd 171 Fed. 645, Cert. Denied 215 U.S. 600, plaintiff entered into a contract with a committee of stockholders and bondholders of a corporation in the hands of a receiver, to purchase all of the stocks and bonds lodged with the committee at a fixed price. The purchase would have given the plaintiff control of the corporation. After this contract was made, the committee entered into a contract with the defendant to sell to the defendant the same stocks and bonds and did sell, and the committee did deliver the

stocks and bonds to the defendant. *The defendant knew, at the time of the purchase, that the committee was under contract to sell the securities to the plaintiff*. Plaintiff sued the defendant in equity for an accounting of the profits realized by the defendant from the purchase of the securities on the ground that the purchase constituted an unlawful inducement to the committee to breach the contract with the plaintiff. The Court held:

> "In other words, while it may be supposed that the complainant meant to charge that Smith & Co. interfered with the carrying out of his contract of September 12th, and persuaded or induced the committee to break that contract, no such charge appears in the bill. The *only complaint is that Smith & Co. had prior knowledge of the complainant's contract* when they began the negotiations that resulted in the agreement of January 25th.
>
> "Under all the authorities the bill is fatally defective on this point. The complainant's *cause of action does not rest upon contract,* for he had no such relation with Smith & Co. It must be *founded on a tort,* on a wrong done by Smith & Co., and must be supported by the proposition that it is an actionable wrong to make a second contract with a promisor if he is known to have had a prior contract upon the same subject with another promisee. *In my opinion, this proposition is not sound.* The promisor may have excellent reasons for declining to be bound by the earlier contract, and these he need not disclose. If he chooses to take the risk of breaking the first agreement, that is his own affair, which may make him liable on that agreement, but imposes no obligation on the second promisee. It is enough for the second promisee that the agreement is now offered to him *without his own procurement or persuasion.* If he has done nothing to bring the situation about, *the mere fact that he knew of the first contract is no bar*

to his entering upon the second. Mere knowledge of the first does not make the second an actionable wrong; he is under no legal obligation to insist upon being told why the promisor declines to carry out the first contract, and is not bound to weight these reasons and decide at his peril whether they are good or bad. Before he can be called to account, some legal ground of liability must appear; he must participate in the breach before he can be held to blame; and the *mere knowledge that the first promisee intends to break the contract is not wrongful in itself,* and does not disable the second promisee from making the subsequent contract. *To be blameworthy, he must take some active step to bring about the breach. At the least, he must induce or persuade the first promisee to abandon the earlier agreement,* and even this he may sometimes do with impunity, unless the decisions in several jurisdictions are to be regarded as erroneous.

. . . . .

"I have been referred to no decision, and I have found none, in which mere knowledge of the earlier contract was held to be the equivalent of inducement or persuasion or (still less) of fraudulent conduct. In none of these elaborate considerations of the subject will there be found the slightest intimation that mere knowledge by a third person of a prior contract exposes him to suit if he shall in effect agree to take the place of the first promisee. In my opinion, therefore, the bill under consideration fails to set forth a cause of action against Edward B. Smith & Co." (Emphasis supplied.)

The Court also held that the plaintiff's remedy, if any, was in any event at law and not in equity, but the Court made no actual determination of this question because it was unnecessary to the decision having determined that there was no liability in any event.

On appeal, the Circuit Court of Appeals for the Third Circuit (171 Fed. 645) held:

> "The facts are that Sweeney had a contract with the committee by which he was to purchase these bonds and stocks. For some reason, which reason does not concern the present appeal, further than to say that Smith & Co. had no relation to or part in the committee's action, they refused to carry out their contract with Sweeney. The committee subsequently sold the stock and bonds to Smith & Co., who knew there had been a prior contract between Sweeney and the committee and that the latter refused to be bound by it. No allegation of fraud, bad faith, or any act of Smith & Co. to induce a breach of said contract by the committee, is here involved. Under these facts there is no liability of Smith & Co. to account to Sweeney. Neither privity of contract, accounts, nor a trust relation, express or implied, exists between them. The contention of liability to account as applicable to personal property finds support in no case, and would unduly trammel and preclude that merchantable character of personalty, which gives it its transmissible commercial value."

In *Caldwell, et al. v. Gem Packing Co., et al.,* 125 P. 2d, 901, 904, the Court held:

> " * * * However, if there was an adequate consideration for the transfer we know of no principle of law which would make Producers liable to plaintiff merely because *it sought to and did purchase its assets knowing* that the effect thereof would be to cause Gem to breach its contract. Even if the motive of Producers involved this supposed evil intent, motives are not actionable. * * * " (Emphasis supplied.)

In *Horth v. American Aggregates Corporation,* 35 N.E. 2d 592, 597, 598, the Court held:

"We determine that the entire record presents *no evidence on the issue of malicious inducement, other than evidence that defendant* at the time it entered into its contract with the Cable Brothers on June 6, 1935, and later on October 21, 1935, *had knowledge* that the Cable Brothers had previously contracted with Horth for some of the same work. * * * "

. . . . .

"By reason of the dearth of authorities in Ohio, we are moved to consider authorities and cases in other jurisdictions. In the Restatement of the Law of Torts adopted and promulgated by the American Law Institute, published May 13, 1939, under topic heading, 'Inducing Breach of Contract or Refusal to Deal,' Section 766, at page 59, under subheading 'i' we find the following: . . . . . "

The Text has already been quoted.

In *Pestel Milk Co. v. Model Dairy Products Co., et al.,* 52 N.E. 2d 651, 658, the Court held:

" . . . it is not a malicious inducement of a breach of contract for the Model Company to enter into an agreement with Burns and Dillon with knowledge that Burns and Dillon had a contract with the Pestel Company covering the same milk routes and with knowledge that both contracts cannot be performed." (Emphasis supplied.)

In Interference, 30 Am. Jur. 75, the text says:

"On the other hand, it is evident that mere knowledge of a contract relation between other parties concerning the subject matter of a transaction is not enough to hold one liable for procuring breach of contract. For example, the fact that a purchaser of bonds had knowledge that the seller had previously contracted to sell them to another does not render the purchaser liable to such other for damages because of the seller's breach of contract, in the absence of in-

ducement or persuasion to breach the contract, or of fraudulent conduct."

In *United States v. Newbury Mfg. Co.*, 36 F. Supp. 602 (D.C. Mass), the Court held:

"It is argued, however, in behalf of the plaintiff, that this corporation is liable to the plaintiff *in tort* for maliciously interfering with the performance of the contract made by Newbury.

. . . . .

"The allegations that Belmont was organized since the contract was made, with interest and control identical with Newbury, and that *with full knowledge of the restriction placed upon the sale* it purchased and re-sold a quantity of the goods, and that this was done pursuant to a conspiracy with Newbury to violate the terms of the contract, if proved, *do not, in my opinion, bring the case within the rule.*

. . . . .

"Belmont did not render Newbury unable to perform, or persuade it by fraud or deceit to pursue a course of conduct in violation of the plaintiff's contract. It is my opinion that the rule cannot be applied to a case where a successor corporation is employed by its predecessor as an instrumentality by which the latter proceeds to violate its contract." (Emphasis supplied.)

In *Lamport v. 4175 Broadway, Inc.*, 6 F. Supp. 923, the Court held:

"It is recognized generally that *it is a tort to induce another to break his contract,* and the question now is whether it is likewise a tort to make a contract *with notice that its performance will involve a breach by the other contracting party of an antecedent contract* with another. It was held in Sweeney v. Smith (C.C.), 167 F. 385, affirmed in (C.C.A.) 171 F. 645,

certiorari denied in 215 U.S. 600, 30 S.Ct. 400, 54 L.Ed. 343, that there is no liability in such a case.

. . . . .

There seems to be no case to the contrary.

"It may be argued that there is no difference in principle between a case where the defendant *actively induces* the breach of a contract between other persons and a case where he makes a contract which he knows will result in the breach of the antecedent contract; that the injury to the plaintiff in each case is the same. But the rule of liability in tort in these cases has never been pushed to its logical limits. *It is settled that mere negligent interference with a contract right is not a basis of liability,* Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303, 48 S.Ct. 134, 72 L.Ed. 290; also that *mere nonfeasance does not subject a person to liability in tort,* although the nonfeasance may result in a breach of the plaintiff's contract. New York Trust Co. v. Island Oil & Transport Corporation (C.C.A.) 34 F. (2d) 649." (Emphasis supplied.)

The purchase of the Logging Company's interest in the timber lands and contracts from the Logging Company may be described in the language of Judge Mack in the Kelly case as

"noninducing interference or participation by the third party"

and as such

"is not actionable at law as a tort."

Under these authorities, the Corporation cannot be held liable for purchasing the timber lands and timber contracts from the Logging Company. The mere knowledge of the existence of the contract between the Lumber

Company and the Logging Company, did not, under the authorities, constitute a tort, to-wit, inducement to breach that contract.

Assuming, without admitting, that the Logging Company breached the contract, it alone would be liable for the damages resulting therefrom.

There is not the slightest intimation in the evidence that the Corporation purchased the timber lands for the express purpose of bringing about a breach of the contract between the Lumber Company and the Logging Company. The Corporation did not seek the purchase of these timber lands. It was solicited by agents of the Logging Company to purchase its equity in the timber lands. Its intention and purpose was to make a desirable purchase of timber lands and not to bring about or cause a breach of the contract. It agreed to pay $1,150,-000.00 for the timber lands.

The Logging Company did not believe it was committing a breach of the contract with the Lumber Company in selling its equity in the timber lands to the Corporation. The Logging Company believed that the timber lands and contracts were conveyed to the Lumber Company to secure the payment of loans; that, in legal contemplation, the Logging Company was a mortgagor and the Lumber Company a mortgagee with all the incidents inherent in that relationship; that upon the payment of the loans, the Lumber Company Mortgagee's interest in the property terminated and thereafter it held the naked legal title in TRUST for the Logging

Company; that it was then the owner of the property and had the right to sell it.

As a matter of law, the Logging Company was justified in that belief (Point I, Glaser and Glaser Brief). If the Corporation was chargeable with knowledge of the contract, it, too would be justified in believing that the Logging Company had the right to sell the property and that the Corporation had the right to buy it because Buel and Carr (the Corporation) had been told that the loans had been paid (Tr. 271).

Assuming, without admitting, that the Logging Company and the Corporation were both mistaken in their belief that the Logging Company had the right to sell its equities in the timber lands, the purchase of the timber lands by the Corporation does not constitute the *tort* of inducing a breach of the contract.

POINT II

The Court below erred in finding that the Corporation was guilty of trespass and rendering judgment against it for treble the value of timber ($50,000.00) alleged to have been removed by the Corporation from the Belding tract, being part of the timber lands purchased by the Corporation from the Logging Company.

Argument

The timber removed, for which damages were allowed in the sum of $50,000.00 and trebled by the judgment, is alleged to have been cut from the Belding tract.

When the Logging Company sold and conveyed all of the timber lands and timber contracts to the Corporation, the Logging Company had paid the Lumber Company in full for all "advances", including interest thereon. (Findings, Tr. 78, IV.)

Since the timber lands had been conveyed to the Lumber Company in the first instance as security for the "advances", it held the legal title for that purpose only, and when the "advances" were paid in full, it held only the naked legal title in TRUST for the Logging Company. The Logging Company was then, in equity, the sole owner of the timber lands and contracts (Point I Glaser & Glaser Br.).

Assuming, without admitting, that the option to the Lumber Company to purchase logs at market prices survived the payment of the indebtedness, that option did not, and could not, affect the Logging Company's ownership of the timber lands. The only thing that survived, was the option to purchase the logs that would be cut therefrom. After payment was made of all "advances", the Logging Company was cutting its own logs from its own timber lands of which *it was, at all times in possession.*

It is conceded that the Logging Company was not a trespasser at any time on these timber lands. (Tr. 286.) It is only claimed that the Corporation was a trespasser. (Tr. 286.)

When the Logging Company sold the timber lands to the Corporation, it sold its own lands; it was in possession thereof and passed its equitable title thereto, to the

Corporation. When the Corporation cut timber on the Belding Tract, it was not a trespasser. It had the possession of the lands and it had the equitable title thereto as grantee from the Logging Company who had the equitable title *and possession.*

Assuming that the Lumber Company had a subsisting option to purchase logs (not timber lands), the Corporation took the equitable title to the timber lands subject to that option and if exercised by the Lumber Company, it was bound to honor it. But the subsistence of that option did not affect (a) the Corporation's possession, and (b) its equitable title.

Trespass is an invasion of one's *possession or right of possession* of lands. *The Lumber Company had neither possession, nor right of possession.* The holding of the naked legal title in TRUST for the owner did not give the Lumber Company any cause of action for trespass *as against the owner of the equitable title who was in possession.* A mortgagor in possession, is not a trespasser as against the mortgagee. The Lumber Company was merely a mortgagee *out of possession whose debt had been paid.*

If a total stranger had trespassed on the Belding Tract and cut and removed timber, the cause of action for the trespass would not have been in the Lumber Company. That cause of action would be in the Logging Company while it was in possession and ownership of the equitable title and, thereafter, in the Corporation while it was in possession and the owner of the equitable title for it would be their timber that had been removed and not the timber of the Lumber Company.

The judgment, insofar as it holds the Corporation liable for trespass, was the result of the Court's basically erroneous legal concept of the law of trespass. The Court applied the following rule (Tr. 287):

> "The Court: Trespass is a matter that depends upon where the legal title lies; not where the equitable ownership lies."

While this statement may, or may not, be a correct statement of the law when applied to the holder of the legal title *in possession as against a stranger,* it does not apply to the holder of a naked legal title in TRUST for the equitable owner when the equitable owner is himself in possession, because the fundamental rule is that trespass is *an invasion of the right of possession.*

In *Caro v. Wollenberg,* 68 Or. 420, the Oregon Supreme Court held:

> "After a mortgagee has received payment of his debt, he really holds the property in trust for the mortgagor."

In the brief of Appellants Glaser, additional authorities are cited which establish the proposition that where title is conveyed to be held as security for the payment of an indebtedness, that the title is held in trust for the grantor as security and after the debt is paid, the grantee holds only the naked legal title in trust for the grantor.

In the case at bar, the debt had been paid and the Lumber Company merely held the naked legal title in TRUST for the Logging Company. It was not then, or at any other time, in possession of the property. The possession was always in the Logging Company until it con-

veyed its interests to the Corporation and the Corporation was thereafter in possession under its equitable title as successor in interest of the Logging Company. That was the situation at the time of the alleged trespass.

In 52 Am. Jur. 843 (Title: Trespass, Sec. 11), the text says:

> "The gist of a trespass to realty lies in the *disturbance of possession* . . . . . " (Emphasis supplied.)

At page 854, Section 25, the text says:

> "Since, as in the case of trespass to personalty, the gist of an action of trespass to real property is the *injury to the right of possession,* in order to maintain the action the *plaintiff must,* at the time of the trespass, *have been in the actual or constructive possession* of the land on which the acts of trespass were committed." (Emphasis supplied.)

At page 860, Section 30, the text says:

> "Since trespass quare clausum fregit is a *possessory action,* a landlord, being in neither actual nor constructive possession, is not entitled to bring the action during the term of the tenant, although where the tenancy is one at will, some cases permit the maintenance of the action." (Emphasis supplied.)

Here, the actual ownership was, at the time of the alleged trespass, either in the Logging Company or in the Corporation as owners. They were in possession of the property and engaged in logging it. The Lumber Company was not then, nor had it ever been in possession.

The Lumber Company's option to buy logs from the owners at market price which it might never exercise, did not give the Lumber Company possession or any

right of possession of the timber lands and the removal of logs by the Logging Company or the Corporation, was not an invasion of any right of possession in the Lumber Company.

In short, trespass cannot be asserted by the holder of the naked legal title in trust for the owner *as against the owner who always was and is then in possession.*

Section 105.810 Oregon Revised Statutes, upon which the Lumber Company relies, in charging the Corporation with trespass, so far as material, provides:

> " . . . whenever any person, without lawful authority, wilfully . . . . . severs from the land of another . . . . . or cuts down, ... or carries off any tree, timber, ... on the land of another person . . . . . in an action by such person . . . . . against the person committing such trespasses if judgment is given for the plaintiff, it shall be given for treble the amount of damages claimed, or assessed for the trespass."

This statute does not attempt to define who shall be deemed the owner for the purpose of prosecuting such an action. It certainly does not confine the cause of action to the holder of a naked legal title in trust for another. The use of the words "land of another" was obviously intended to give the cause of action to the true or beneficial owner of the land. It obviously leaves for determination, in each case, the question who is the real party in interest or injured by the trespass. It may be a tenant in possession, or the beneficial owner that is injured.

The statute most certainly does not create a cause of action in favor of the holder of the naked legal title *as against the beneficial owner who is in possession.* It only

creates a cause of action in favor of the true owner as *against a stranger* who has no interest in the property and is *not in possession* thereof.

There was no disturbance of the Lumber Company's possession or right of possession for it had none and consequently, there was no trespass as against the Lumber Company.

There is no basis for any judgment in favor of the Lumber Company for the value of the timber for it did not own the timber and certainly none for trebling the damages.

Assuming, without admitting, that the timber was cut and sold in violation of the option, the only remedy in favor of the Lumber Company would be the damage sustained from the failure to tender the logs to the Lumber Company, which damage would be the difference between the market price, which was the base price under the contract, and any amount in excess thereof that the Lumber Company may have been forced to pay in order to obtain an equal amount of timber. But there is not the slightest foundation for an award of the damages consisting of the *value* of the timber when the Plaintiff was not the owner thereof.

POINT III

The Court erred in holding the Corporation liable for $118,000.00 damages for loss of profits allegedly resulting from the failure to supply logs for the operation of the Batterson Mill.

Argument

The action as against the Corporation, is in *tort* and not for breach of contract. The Corporation was not a party to the contract which gave the Lumber Company the option to buy logs for the operation of the Batterson Mill at market price. That contract was with the Logging Company only.

The Lumber Company refuses to recognize the Corporation as an assignee of the contract or as a successor in interest of the Logging Company and the Court below, by its decree, held that the transfer from the Logging Company to the Corporation to be void.

In this situation, the Corporation obviously was under no contractual obligation to supply logs for the operation of the Batterson Mill. Assuming, without admitting, that the Logging Company breached that contract, it does not create any cause of action against the Corporation for such breach. Such a cause of action, if any there be, would be against the Logging Company only.

POINT IV

The Court below erred in awarding $118,000.00 damages for loss of profits allegedly resulting from the failure to supply logs for the operation of the Batterson Mill because there is no substantial evidence that any damage was sustained at all.

Argument

The Court assessed damages against the Corporation, as well as the Logging Company, in the sum of $118,000.00 for loss of profits which the Lumber Company claims to have sustained because it was not given the option to purchase logs for the operation of the Batterson Mill subsequent to October 1st when the mill was re-opened by the Lumber Company or Gould.

Now the contract only gave the Lumber Company the option to purchase logs for the Batterson Mill sufficient for a *one shift operation.* That was the extent of that particular obligation (Tr. 134, Sub-div. d, and 135, Sub-div. a). The testimony of the Lumber Company's own witness, in charge of the particular matter of obtaining logs for that mill, establishes that the mill had sufficient logs to operate that mill on a *one shift basis* during all of the time in question.

William O. Gansberg, the Lumber Company's employee and witness, testified (Tr. 468) that he was sent down to the Batterson area by Mr. Holm to secure suitable logs for the mill at Batterson. (Tr. 469.)

"Q. What is the fact as to whether or not you were able to get all the logs you needed to operate the Batterson Mill after January 16th, 1952?

A. Well, we were able to get enough logs to run on a one-shift basis . . . . . "

He also testified that part of the time the mill was shut down because of strikes (Tr. 470) and because of fire weather (Tr. 471). He then testified, on cross examination:

"Q. Did you buy all the logs that were offered to Buffelen Manufacturing Company at the millpond or for the millpond?

A. Yes. I marked the logs that were to be sent over to the millpond.

Q. Did you buy the million feet of logs that were offered by Smith & Wright?

A. The ones that were suitable for our operation." (Tr. 471.)

. . . . . .

Q. How many shifts did you operate?

A. One.

Q. One shift straight through during all of the time that you were operating; is that correct?

A. No. There were shutdowns for strike and fire weather."

This evidence coming from the Lumber Company's own Representative and witness clearly establishes that it sustained no loss of profit from the operation of the Batterson Mill because it had all the logs it needed for the one shift basis, which was the extent of the option obligation.

POINT V

The Lumber Company could not, in any event, maintain an action for loss of profits resulting from the alleged failure to supply logs to the Batterson Mill because it had transferred the operation of the Mill to Roy Gould or his corporation, Diamond Lumber Company, under an agreement by which they were to receive all profits from the operation of the Mill subsequent to October 1, 1951, and they were to sustain all losses therefrom. The Lumber Company is not the real party in interest in this respect.

Argument

The record establishes that prior to September 27, 1951, the Lumber Company had entered into negotiations with Roy Gould and/or Diamond Lumber Company for the sale of the Batterson Mill. The mill had been shut down on June 29, 1951, and was not opened until October 1, 1951. Gould, Plaintiff's witness, testified (Tr. 235) that an arrangement had been made that the Diamond Lumber Company was to operate the mill and that it was to have the profits from its operation.

George Holm, the Lumber Company's division manager and witness, testified (Tr. 255) that Gould (Diamond Lumber Company)

> "was to receive all the profits from the operation of the mill while he was so operating"

and that he was to

> "assume any losses if there were any losses sustained."

Assuming, without admitting, that loss of profits was sustained from the alleged failure to supply logs to the Batterson Mill, it was not the Lumber Company's loss. It was the loss of Gould or Diamond Lumber Company, the operators of that mill subsequent to October 1, 1951, and plaintiff had no cause of action therefor in any event.

POINT VI

The Court below erred in admitting in evidence Appellee's Exhibits 19-A, 19-B, 19-C and 22. The error is highly prejudicial. Without those exhibits, there is not a scintilla of evidence in the record to establish alleged loss of profits.

Argument
Re Exhibits 19A, B and C

Copies of these three exhibits are attached as an appendix to the brief of Appellant Bart MeKenney and Marie McKenney. They purport to be a "cost report" for the operation of the Batterson Mill from June 30, 1949, to May 31, 1951, a period of time preceding the alleged breach of the contract, and purport to show the profits realized and losses sustained from the operation of the Batterson Mill during that period of time.

The alleged loss of profits for which recovery was sought and awarded by the judgment, is for the period of time from October 1, 1951 to the time of the trial of the action, to-wit, December 1952. Only fifteen days of this period preceded the commencement of the action, to-wit, October 15, 1951 (Tr. 6). Appellee claims that

these exhibits show that it realized profits of from six to nine thousand dollars a month during the period prior to the alleged breach. The contention was made and adopted by the Court below that if logs had been supplied to the Batterson Mill during the latter period, it would have realized a similar profit, and the alleged failure to supply logs resulted in the loss of the profits to the extent of $118,000.00.

We have already demonstrated in Point IV that the mill actually was in operation during that latter period of time except for the intervals when the mill was shut down by reason of breakdowns, strikes and fire weather (Tr. 470-474); that it actually operated throughout that whole period of time, except as aforesaid, on a one shift basis (Tr. 469) and that it had sufficient logs, obtained from the timber lands in question and from other sources, to operate the mill on a one shift basis (Tr. 469-470).

(a) Since the mill was in operation after October 1, 1951, on a one shift basis (Tr. 469), the best evidence on the issue of profit and loss was the actual cost of the logs, operating expense, etc. as against gross revenue or income. There was no occasion for resorting to past experience for that purpose. Evidence of past experience might be admissible if the mill had been entirely shut down so that primary evidence would not be available. Moreover, profit and loss, as reflected in the exhibit, may have resulted from very favorable market conditions for the sale of lumber or from the introduction of efficient operating methods and the like. The exhibits

themselves demonstrate that the profit figures shown thereon, have no probative value because it appears that from month to month the profits and losses varied tremendously and had no relation to the quantity of logs cut in that mill. There was no substantial consistency between the amount of logs cut and the profits or losses realized which would warrant the acceptance of the figures as a true indication of probable profits if the mill was in operation.

For example: In the month of May 1951 (p. C-14, Ex. 19-C), the mill cut 1,780,803 feet of lumber and showed a "book profit" of $4,298.41; whereas, in the month of June 1951 (p. C-12 of Ex. 19-C) they cut 1,896,434 feet of lumber and sustained a loss of $13,-997.60. In other words, although they cut more lumber, they sustained almost a $14,000.00 loss. This illustration can be duplicated many times by reference to the exhibits, demonstrating conclusively that the tabulations do not truly reflect profit and loss from operations, and that there is something seriously wrong with the method of building up the summaries.

(b) The exhibits consisted of "summaries" arbitrarily made from Plaintiff's books, but the account books were not produced in court (admitted, Tr. 204). Appellants had no opportunity to examine the books or cross-examine the accountant who prepared the summaries to verify the accuracy thereof. There was no way of determining whether the books from which the summaries were made, truly reflected all of the elements that affect the realization of profit or loss. There was no

opportunity to inquire into the inter-company or departmental relations and transactions to determine whether the costs allocated as between them, were true or fictitious or purely arbitrary.

The precautionery conditions precedent to the use of summaries were entirely ignored.

Objection was made to the introduction of the exhibits.

The Court below was apparently of the opinion, when the exhibits were first tendered, that the books of account were in Court, for during the cross-examination, the Court inquired:

"Aren't the books here? (Tr. 204)

. . . . .

The Court: I understand, but then aren't the books here?

Mr. Dezendorf: The books are not here. No.

The Court: I understood you to say before that they were."

We submit that the admission of these summaries violated the fundamental rule that summaries are only admissible in evidence when the records from which they were made, are themselves brought into Court and made available for the inspection of the other party and for a cross-examination, and that in the absence of such precautionery measures, summaries are not admissible.

The summaries are not original books of entry, nor are they account books kept and maintained in the ordinary course of business. There is not even a word of testimony that the records from which the summaries

were made, were accurately kept, and that they correctly reflect the operations.

The exhibits were clearly inadmissible:

Hooven v. First National Bank, 66 A.L.R. 1204, 273 Pac. 257, 134 Okl. 217;
20 Am. Jur. p. 698, Sec. 831;
Wigmore, Evidence, Sec. 1230;
1 Greenleaf, Evidence, Sec. 93.

In the *Hooven* case, the Court said:

"We realize that the use of summaries is an exception to the rule and countenanced only by reason of necessity and convenience; a safeguard and prerequisite is the production of the originals in court and an opportunity for inspection of them by the adverse party."

In 20 Am. Jur., Sec. 831, page 698, the text is as follows:

"Also where books and papers are voluminous, a qualified witness may summarize and explain the facts shown by such books and papers *when they are all in court and the opposing counsel has full opportunity to cross-examine as to the correctness of the witness' testimony*. It is said, however, that in such cases it is not proper for the expert simply to testify that the books show certain facts. The *books themselves must be introduced as primary evidence* and the testimony of the expert is secondary and explanatory only." (Emphasis suupplied.)

Re Exhibit 22

Exhibit 22 is printed in full at page 480 of the transcript. It purports to be a summary of the profits and losses for the period July 1, 1951, to October 31, 1952. The first three months appearing thereon, July, August

and September, 1951, is the period preceding the alleged breach of contract and during which the mill was voluntarily closed by the Lumber Company for vacations and for repairs, etc. The balance of the summary purports to cover the period subsequent to the alleged breach. The summary was offered in evidence (Tr. 462). Objection was interposed on the ground that no foundation for it had been laid; that it was a mere conclusion; that there was no showing that the figures were correct or what they were derived from, and that it was a purely self-serving document (Tr. 463). The Court, at first, excluded the document (Tr. 464). The evidence showed that part of the time the mill was shut down by reason of strikes, breakdowns, and also on account of fire weather (Tr. 470-471). Miles testified (Tr. 475) that he had the books from which the summary was prepared and that it was an accurate representation of what the books show.

But there is not a word of the testimony that the books of account accurately reflect the operations. The exhibit was again offered in evidence. Lengthy objections were interposed (Tr. 475-477), and the Court admitted the exhibit (Tr. 479), saying:

> "The Court: I think with the situation as it is, I will receive it. I will still consider your objection after I consider all the testimony."

We submit that the exhibit was improperly admitted for a number of reasons:

First: It shows, on its face, that in October, November and December, the mill was operated by Gould (Diamond Lumber Company) and the record estab-

lishes, by Plaintiff's own witnesses, that Gould operated the mill under an agreement that he was to realize the profits and absorb the losses if any there be. Hence, the Lumber Company cannot claim any loss of profits which, in any event, would have been the property of Gould.

Secondly: The exhibit shows that during the remaining ten months, January to October, the mill operated six months on a one shift basis; that it was closed in January, February, and March, and it shows there was a strike in May. The reasons for the closure in January, February, and March, is not disclosed by the exhibit. But Gansberg, Plaintiff's representative who looked after the supply of logs for the mill, testified that they had enough logs during the period from January 1952 to run the mill on a one shift basis and that they had shut-downs by reason of strikes, mill break-downs, and fire weather (Tr. 469 to 471), it is evident that the closure during the months of January, February and March was not due to failure to supply logs, but was due to the other causes described by him.

The lack of probative value of the exhibit appears from its face because of numerous absurd results disclosed by the figures.

For example: In the month of March 1952, the mill was closed and yet it shows fixed expense of $20,837.76 as against $5,771.24 for the month of April when the mill was in operation.

Another illustration: In July 1952, the mill operated on a one shift basis. It had a payroll for that month of

$9,626.86 with a loss of $570.05, while in the mouth of August with substantially the same payroll, $9,357.95, on a one shift basis, it shows a profit of $7,414.86. Such figures cannot be reconciled and a summary producing such results, obviously cannot be evidence of profits and loss upon which a judgment is to be predicated.

The admission of these exhibits is highly prejudicial for the reason that the award of $118,000.00 damages was predicated upon these exhibits. It was by means of these exhibits that it was claimed that the mill had been earning from six to nine thousand dollars a month in the prior period and this monthly profit allegedly earned during the earlier period, was applied to the subsequent period entirely upon those exhibits.

Without those exhibits in the record, there is not a scintilla of evidence upon which a finding can be sustained that (a) losses were sustained subsequent to October 1, 1951, and (b) the amount thereof.

CONCLUSION

For the reasons assigned in the brief of the Appellants Einar Glaser and Dorothy Glaser, and for the reasons assigned herein, the judgment against the Corporation should be reversed.

Respectfully submitted,

S. J. BISCHOFF,
LEO LEVENSON,

Attorneys for Appellant McKenney Logging Corporation.

No. 14188

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

BRIEF OF APPELLANTS EINAR GLASER and DOROTHY GLASER

Appeals from the United States District Court for the District of Oregon.

S. J. BISCHOFF,
LEO LEVENSON,
Attorneys for Appellants Einar Glaser and Dorothy Glaser.

STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 5-54

SUBJECT INDEX

SUBJECT INDEX (Cont.)

TABLE OF CASES

No. 14188

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BRIEF OF APPELLANTS EINAR GLASER and DOROTHY GLASER

Appeals from the United States District Court for the District of Oregon.

STATEMENT OF JURISDICTION

Jurisdiction of the United States District Court for the District of Oregon is based on *Title 28 U.S.C.A., Sec. 1332* (Diversity of Citizenship).

The complaint alleges that Plaintiff is a California Corporation that Defendants Einar Glaser and Dorothy Glaser and Defendants Bart McKenney and Marie McKenney, and Defendant J. B. Carr, are citizens of the State of Oregon; that Defendant Edward M. Buol is a citizen of the State of Washington and Defendant McKenney Logging Corporation is a Washington Corporation, and that the matter in controversy exceeds, exclusive of interests and costs, the sum of $3,000.00 (Tr. 1). These allegations are admitted (Pretrial Order, Tr. 10).

The jurisdiction of this Court is based on *Title 28 U.S.C.A., Sec. 1292.*

ABSTRACT OF THE CASE

For the purpose of convenience, the parties will be referred to as they are designated in the contract.

Plaintiff-Appellee Buffelen Manufacturing Co. will be referred to as the "*Lumber* Company".

Defendants-Appellants Bart McKenney and Marie McKenney, husband and wife, and Einar Glaser and Dorothy Glaser, husband and wife, co-partners doing business under the name of McKenney Logging Company, will be referred to as the "*Logging* Company".

Defendant-Appellant McKenney Logging Corporation will be referred to as the "Logging *Corporation.*"

The Lumber Company is the assignee of the contract involved herein and will be referred to herein as

though it was the party to the contract from the inception.

The complaint charges violation of the contract (Ex. 1, Tr. 125), supplemented by contract (Ex. 2, Tr. 146).

The Lumber Company was engaged, among other things, in operating sawmills for the manufacture of lumber, and a plywood mill for the manufacture of plywood.

The Logging Company (partnership) was engaged in the business of logging timber lands and selling the logs to saw and plywood mills. It logged timber lands, which it owned outright, and timber lands, which it held under contract of purchase, as well as contracts giving it right to cut and remove timber from the lands of others, including the State of Oregon, and Clatsop County, Oregon.

For some time prior to the making of the contracts involved herein, the Logging Company sold logs to the Lumber Company and the Lumber Company, from time to time, "advanced" monies to the Logging Company for various purposes, including the purchase of timber lands and contracts.

The contract, so far as material at this point, provides that the Lumber Company has "advanced" monies to the Logging Company for the acquisition of timber lands and timber contracts, construction of roads, a bridge over the Nehalem River, equipment and for other purposes, and, *particularly, for the completion of the purchase of what is referred to as the "Belding Timber," "Tillamook Yellow Fir Timber," and "Scritsmier*

Timber" upon which the Logging Company had contracts of purchase and which it had been logging. Payment in full had to be made by December 1, 1946, or the contract would be forfeited. The monies "advanced" were used, among other things, to make payment for said lands.

To secure the re-payment of the "advances", the title to these timber lands was taken in the name of the "Lumber Company" and the Logging Company was required and it did, at the same time, transfer to the Lumber Company, the title to timber lands which the *Logging Company already owned,* as well as transfer of all of the *timber contracts which the Logging Company owned.*

Provision was made for the re-payment of the "advances" with interest at the rate of 4% per annum. Taxes and all other carrying charges were to be paid by the Logging Company.

The Lumber Company was given the *option* to purchase "all" "the entire output" of the logs to be logged from all of the timber lands at market price. Payment for the logs was to be made by the Lumber Company ten days after invoice.

Provision was made that the Lumber Company should deduct $5.00 per thousand from the purchase price of all logs to be applied to the payment of all "advances" until the full amount of all "advances", for all purposes, plus interest, were paid. The title to all of the timber lands and timber contracts was to be reconveyed to the Logging Company on the conclusion of

the operations for a consideration of $1.00 if all "advances" were re-paid.

By June 1950, the Logging Company had re-paid to the Lumber Company all "advances" for the purchase price of timber and other purposes, together with the interest thereon. (Finding of Fact, par. IV Tr. 87 and stipulated facts in pre-trial order, par. IV Tr. 12).

On or about September 1, 1951, the Logging Company sold and transferred to McKenney Logging Corporation, all of its interests in said timber lands and timber contracts. The partners of the Logging Company had no interest in this corporation. It was organized by Buol and Carr.

The complaint charges violation of the contract by the Logging Company in two respects:

(a) Transferring of the assets to the Corporation without the written consent of the Lumber Company;

(b) Alleged failure of the Logging Company and the Corporation to sell logs to the Plaintiff.

The cause of action against the Logging Company is for *breach of contract.*

The cause of action asserted against the Corporation is in *tort* for unlawfully inducing a breach of the contract.

Plaintiff prayed for judgment and decree:

(a) Enjoining the Logging Company (Partnership) from breaching the contract;

(b) Enjoining the Logging Corporation and Carr and Buol from interfering with or inducing breach of the contract, and from trespassing

upon and cutting or injuring Plaintiff's land and timber thereon;

(c) For damages.

The damages claimed, upon the trial, and allowed by the Court, were:

(a) $50,000.00 the value of 2,000,000 feet of logs, allegedly removed by the Corporation, from the Belding Timber lands;

(b) $118,000.00 alleged loss of profit from the alleged failure to supply logs to the mill at Batterson, Oregon.

The decree also

(1) Permanently restrained the Logging Company (Partnership) from breaching the contract;

(2) Restrained the Corporation from trespassing on the lands or injuring, or cutting, timber thereon, and from interfering with or inducing a breach of the contract;

It was also decreed

(3) That the sale by the Partnership to the Corporation and transfer of their assets be cancelled, set aside, and declared void and of no effect;

(4) It rendered judgment against the Partners in the sum of $168,000.00, being the sum of $50,000.00 for the removal of the timber and $118,000.00 for loss of profits resulting from the failure to supply logs for the operation of the mill at Batterson, Oregon.

(5) Judgment was rendered against the Corporation for the same amounts except that the damages of $50,000.00 for the removal of timber was trebled, making the total judgment against the Corporation, $268,000.00.

The appeal is from that judgment and decree.

THE QUESTIONS INVOLVED

The principle question is the construction of the contract between the Lumber Company and the Logging Company. All other questions are subsidiary thereto and are in a large part, if not entirely, determinable by the interpretation which the Court will place upon the contract.

Appellants contend that the transaction, evidenced by the contract, is, in equity, merely a loan of money by the Lumber Company to the Logging Company; that all of the lands described in the contract were transferred to the Lumber Company, to secure the loans and not to vest absolute title in the Lumber Company; that the relation between the parties was that of mortgagor and mortgagee; that while the loans were unpaid, the Lumber Company held the title to the lands as security merely; that when the loans were paid in full in June 1950, the Lumber Company ceased to have any interest in the lands and held the naked legal title in trust for the Logging Company; that thereafter the Logging Company was the sole owner of the timber lands and contracts; that after June 1950, the only surviving right, if any, of the Lumber Company, under the contract, was an "option" to purchase logs from the Logging Company at market price; that thereafter the cutting and removal of logs from those timber lands, either by the Logging Company or by the Corporation, was not a conversion of the Lumber Company's property; that the appellants were the owners thereof, had the right to remove the same and were not guilty of

either conversion or trespass; that if there was any liability to the Lumber Company at all by reason of the removal of logs from those lands (assuming the Lumber Company had a subsisting option to purchase said logs and had exercised the option), it would be for the difference between the price which the Lumber Company was required to pay appellants for the logs (market price) and the price which the Lumber Company was obliged to pay therefor to replace them.

Appellants contend that they were not liable to plaintiff for the alleged removal of 2,000,000 feet of logs of the alleged value of $50,000.00, because:

(a) The Lumber Company was not the owner of the logs;

(b) There is no substantial evidence to establish the quantity of logs removed; that they were removed from the Belding tract; that the Lumber Company ever exercised the option to purchase said logs.

Appellants contend that they are not liable for the $118,000.00 of damages alleged to have been sustained by reason of the alleged failure to supply logs to the Batterson Mill, because:

(a) There is no substantial evidence that the Lumber Company sustained any damage at all. The record establishes affirmatively that the Batterson Mill obtained a sufficient quantity of logs to operate the mill during the time in question on a *one shift basis,* that being the extent of the obligation under the contract.

(b) There is no substantial evidence to sustain any operating loss, the evidence introduced being both speculative in character and otherwise incompetent.

Defendants-Appellants contend that the Plaintiff failed to establish any cause of equitable cognizance or equity jurisdiction. Assuming that the Lumber Company had a surviving option to purchase logs, such option does not create any interest in property prior to exercise of the option, and the Lumber Company had an adequate remedy at law for a violation of the option if any there be, to-wit, the recovery of damages measured by the difference between the contract price and the amount it would have to pay for logs.

Appellant Corporation contends that there is no substantial evidence in the record to establish that it unlawfully induced the breach of the contract.

SPECIFICATION OF ERRORS

I.

The Court erred in granting equitable relief, to-wit: injunction and cancelling, and setting aside, the conveyances from the Logging Company to the Corporation on the ground that the case presented no ground of equitable cognizance. The Plaintiff had an adequate remedy at law for the alleged breach of the contract.

II.

The Court erred in finding (VIII, Tr. 88) that McKenney and Glaser did not tender logs to the Lumber Company.

III.

The Court erred in finding (X, Tr. 88) that the Corporation removed 2,000,000 feet of timber from Plaintiff's land after September 1, 1951, of the value of

$25.00 per thousand feet and that the Lumber Company was damaged in the sum of $50,000.00 by reason thereof.

IV.

The Court erred in finding (XI, Tr. 88) that the Corporation had knowledge of the contract between Plaintiff and Logging Company and that the Corporation removed timber from Plaintiff's land wilfully and intentionally.

V.

The Court erred in finding (XII, Tr. 88) that Plaintiff sustained damages in the sum of $118,000.00 for loss of profits in the operation of its mill at Batterson and in the sum of $50,000.00 for timber removed by the Corporation and by the attempted sale of the properties by the Logging Company to the Corporation.

VI.

The Court erred in finding, if it be deemed a finding, (XIII, Tr. 89) that Plaintiff sustained damages in the sum of $118,000.00 by reason of the Corporation's interference with and inducing Defendants McKenney and Glaser to breach the contract.

VII.

The Court erred in finding that the Corporation refused to tender to Plaintiff for purchase, all logs removed by it from the lands referred to in the contracts (XIV, Tr. 89).

VIII.

The Court erred in finding (XV, Tr. 89) that the Corporation refused to dump all logs removed by it

from the lands and rights covered by the contract, into the pond at the Batterson Mill.

IX.

The Court erred in finding (XIV, Tr. 89) that the purpose and intent of the contract, Exhibit 1, was not an accommodation or an advance of money by Plaintiff to McKenney and Glaser with which to purchase the timber lands, and in refusing to find that the transaction was, in equity, a loan of money by the Lumber Company to the Logging Company; that the transfers of title to the plaintiff were made as security therefor, and in failing and refusing to find that the relationship of the parties was that of mortgagor and mortgagee.

X.

The Court erred in making the conclusion of law (I, Tr. 90) that the contract was unbreached by the Plaintiff on September 1, 1951.

XI.

The Court erred in the conclusion of law (II, Tr. 90) that McKenney and Glaser were obliged to tender all logs produced by them from the logs covered by the contract to Plaintiff for purchase prior to selling them to others.

XII.

The Court erred in the conclusion of law (III, Tr. 90) that McKenney and Glaser were not in a position to sell their interest in the lands to the Corporation, and in refusing to hold that the Lumber Company had acquiesced therein.

XIII.

The Court erred in the conclusion (IV, Tr. 91) that the Corporation was charged with knowledge of Plaintiff's ownership of the lands and contracts at the time of the transfer thereof by the Logging Company to the Corporation.

XIV.

The Court erred in the conclusion (V, Tr. 91) that the contract, in question, was not a loan and security agreement.

XV.

The Court erred in the conclusion (VI, Tr. 91) that McKenney and Glaser, on September 1, 1951, or prior thereto, were not the owners of the timber lands and contracts described in the contract, and that the said lands and contracts were not held by Plaintiff as security for loans and advances made to Defendants.

XVI.

The Court erred in the conclusion (VII, Tr. 92) that the contract did not terminate upon re-payment of the loans and advances, together with the interest thereon, at least in sofar as it involved the ownership of the lands and contracts described therein.

XVII.

The Court erred in the conclusion (XIII, Tr. 92) that the contract did not limit the Lumber Company's right to logs for use in the Batterson and Tacoma mills, and in refusing to hold that the plaintiff was not entitled, under said contract, to logs for the purpose of selling them to others or trading the logs for lumber,

or for the purpose of supplying logs to Gould or the Diamond Lumber Company, or any other purpose.

XVIII.

The Court erred in the conclusion (IX, Tr. 92) that the purchase by Plaintiff of logs after September 1, 1951, removed from the lands described in the contract by the Corporation, did not constitute a ratification of the transfer from the Logging Company to the Corporation, and that such purchases did not constitute an estoppel to assert a breach by reason of the transfer of the Logging Company's interest to the Corporation without Plaintiff's written consent thereto.

XIX.

The Court erred in the conclusion (X, Tr. 92) that McKenney and Glaser did not become entitled to a conveyance of the lands described in the contract when they paid in full all of the monies owing to the Lumber Company with interest thereon, and in refusing to hold that upon payment of all loans, McKenney and Glaser were the equitable owners of all the timber lands and contracts, and that Plaintiff held only naked legal title in trust for them.

XX.

The Court erred in the conclusion (XI, Tr. 93) that McKenney and Glaser were liable to Plaintiff for $168,000.00 damages for the reasons assigned therein.

XXI.

The Court erred in the conclusion (XII, Tr. 93) that the Corporation is liable to Plaintiff for three times the value of the logs alleged to have been removed in

the total sum of $150,000.00 for intentionally trespassing on the Plaintiff's land and wilfully and intentionally cutting timber therefrom, and that it was liable for $118,000.00 damages for interfering with the contract between Plaintiff and McKenney and Glaser, and inducing a breach thereof.

XXII.

The Court erred in the conclusion (XIII, Tr. 93) that Plaintiff is entitled to a permanent injunction restraining McKenney and Glaser from breaching the contract, and restraining the Corporation from trespassing on the lands and cutting timber therefrom and setting aside the transfer made by the Logging Company to the Corporation.

XXIII.

The Court erred in the conclusion (XIV, Tr. 94) directing entry of judgment and decree in favor of the Plaintiff.

The grounds upon which the findings are alleged to be erroneous, have been set forth in the previous statement of the questions involved.

XXIV.

The Court erred in excluding Defendants' Exhibit No. 24 (Tr. 555), being a contract (Tr. 556) entered into on May 22, 1946, between the parties which preceded and was the genesis of the transaction referred to in the contract, Exhibit 1 (Tr. 126).

XXV.

The Court erred in admitting in evidence Plaintiff's Exhibits 19-a, 19-b and 19-c over Defendants' objection

(Tr. 200 to 202). (The exhibits are too lengthy to be re-produced at this point and are elsewhere referred to.) The exhibits consist of tabulations of "cost reports" made by Plaintiff and were objected to on the ground that they were immaterial and related to periods of time not in controversy (Tr. 202).

XXVI.

The Court erred in admitting in evidence Plaintiff's Exhibit No. 22 over Defendants' objection (Tr. 475 to 480). The exhibit appears at page 480 of the transcript. It purports to be a profit and loss statement of the operation of the Batterson Mill prepared by Plaintiff. It was objected to (Tr. 475) when offered (Tr. 462) on the ground that there was no foundation for it; that it was not pertinent to the issues; that it was merely a conclusion; that there was no evidence that the figures were correct or what they were derived from, and that it was a self-serving document. The Court excluded the document at that time (Tr. 464). It was again offered (Tr. 475) and was again objected to (Tr. 475 and 476) and was admitted conditionally as follows:

> "The Court: I think with the situation as it is, I will receive it. I will still consider your objection after I consider all the testimony."

The exhibit was received "subject to the objection" (Tr. 479).

STATEMENT OF FACTS

In the years 1943, 1944, and 1945, McKenney was engaged in logging operations and the Lumber Company was purchasing substantially all of his output of logs. In those years, McKenney borrowed money from the Lumber Company to carry on operations and the loans were secured by chattel mortgages on McKenney's equipment. During that period of time, McKenney entered into a contract with Belding Logging Company to buy from it green timber, which included timber lands containing about 32,000,000 feet of timber. This included timber which the Belding Company was buying from the Tillamook Yellow Fir Company. Under that contract, McKenney was required to pay for all of the timber land on or before December 31, 1946. After he had been logging for some time on this land, it became apparent that he was not going to be able to pay the balance of the purchase price by that date line. He applied to the Lumber Company for a loan of money with which to complete payment for that timber, and the Lumber Company "advanced" the money (Tr. 282-283). When this money was "advanced", a written contract was entered into (Def. Exh. 24, set out in full, Tr. 556). It was offered in evidence, but was rejected by the Court as "entirely immaterial" (Tr. 555), and the ruling is assigned as error.

This earlier contract, dated May 22, 1946, recites that the Logging Company is the owner of, and has under contract, timber lands having thereon approximately 130,000,000 feet of timber which is described in

a schedule attached to the contract (Tr. 564-567) and are the *same timber lands described in the later contract (Ex. 1), including what is referred to in the case as the Belding Timber, Tillamook Yellow Fir, etc.;* that it is the intention of the Lumber Company to build a sawmill and an unwinding mill (plywood mill); that the Logging Company is the owner of roads, mill sites, re-load facilities, equipment, spur tracks, and other facilities required in logging operations; *that the Logging Company had a contract for the purchase of the Belding Timber and the Tillamook Yellow Fire Company timber,* which required that the timber be logged on or before December 31, 1946 and paid for at the rate of $3.50 a thousand and payment in full for the timber must be made by December 31, 1946 (Tr. 557).

The Lumber Company agreed to build the mills and to "buy" from the Logging Company and "pay for" *all* logs cut from said timber lands. Payments were to be made within ten days after invoice. The Lumber Company agreed to "advance" approximately $50,000.00

> "to be paid on or before December 31, 1946 to the Belding Logging Company and/or Tillamook Yellow Fir Company . . . to protect and acquire good title to the timber which the logger has under contract."

This is the same timber involved in this controversy.

The contract then provides:

> "In the event such 'advance' is made by the Lumber Company, the Logger will *secure such 'advance'* by contemporaneously therewith transferring title to such timber so acquired to the Lumber Company" (Tr. 559).

Provision is made for the deduction of $3.50 a thousand from the purchase price of logs to be applied to the re-payment of the "advances" for the timber,

> "until the full amount of the 'advance' has been paid."

The contract then provides that the Logging Company agrees to sell to the Lumber Company, all the marketable logs cut on the tracts of land described in Schedule A,

> "and also on all other lands now owned or subsequently acquired in the Cook Creek Area" (Tr. 559).

The Lumber Company was to pay the Logging Company for the logs at "the then market price" (Tr. 560). It is also provided that if additional timber lands are acquired in that area, that they should come under the terms of the contract (Tr. 561).

The mills, referred to, were not built at the time the contract (Ex. 1) was entered into on January 8, 1948.

The balance owing on the contracts for the purchase of the Belding and Yellow Fir Timber, was paid on or prior to December 1, 1946, and title thereto was taken in the name of the Lumber Company. (Pl. Ex. 8, Deed recorded January 30, 1947, Tr. 158, and Pl. Ex. 9, Deed recorded January 30, 1947, Tr. 161). The contract recites that it was expected that approximately one-half of the timber on the Belding and Yellow Fir Tracts would be logged and paid for prior to December 31, 1946, at which time the final payment had to be made (Tr. 557).

The written agreement, here involved (Pl. Ex. 1, Tr. 125), is dated January 8, 1948, about a year and seven months after the first agreement was made. It is a novation of the former contract. It recites (Tr. 126) that the Logging Company had for years been engaged in acquiring timber and timber lands and logging contracts; that the Lumber Company and the Logging Company

> "having by either written or oral contracts had an agreement wherein the Lumber Company had the first right and exclusive option to purchase all of the entire output of the logs. . . ."

It further recites that the loggers had entered into a contract with Belding Logging Company under which they were required to complete logging of the Belding timber by December 31, 1946, or

> "forfeit their rights under the contract."

(This is the same contract referred to in the prior contract); that prior to December 31, 1946, it was apparent that the loggers would be unable to complete the logging of the Belding Tract and that it had been agreed that the Lumber Company would acquire the holdings of the Belding Company, the Scritsmier Company and the Yellow Fir Timber Company "with whom" the loggers had a contract (Tr. 126-127); that the timber lands covered by said contract, were acquired at a cost in excess of $130,000.00. It recites further that other timber contracts and cutting rights

> "are owned by the loggers for which, in many instances, the Lumber Company 'advanced' the necessary funds to the loggers;"

and that the parties had agreed that the Lumber Com-

pany would "advance" a substantial sum of money for other purposes (Tr. 127). It further recites that the Lumber Company is the owner of the timber lands and contracts described in Schedules A and B. (These are the same properties described in the earlier contract) and that the Logging Company is the owner of the properties and contracts described in Schedule C. It then recites that the purpose of the Lumber Company is to keep its mill at Tacoma and the mill, which it is building at Batterson, in logs and with no desire on its part to make a profit out of the logging end of its business. After these recitals, it was agreed that the Lumber Company would complete the sawmill at Batterson (the plywood mill was never built); the Logging Company would log the area and pay the Lumber Company $5.00 per thousand feet until all money "advanced," or subsequently to be "advanced" for all purposes, including the purchase of the timber lands and contracts with interest at 4% per annum, and including also all taxes and carrying charges and expenses incurred by the Lumber Company in connection with the purchase of the timber, was paid in full. The $5.00 per thousand was to be deducted from the purchase price which the Lumber Company was to pay to the Logging Company for the logs (Tr. 130-131).

The contract then makes this important provision:

> "In the event, however, when the timber of the Lumber Company is all logged, the logger shall pay to the Lumber Company any additional amount required to reimburse it for the total cost of those holdings as herein defined and in the event the logger has paid more than the actual cost, then

> the Lumber Company shall refund such over-payments to the loggers" Tr.. 131).

The contract then makes provision for the purchase of logs by the Lumber Company from the Logging Company removed from all of the lands at "market price" (Tr. 131-132); and for the *re-conveyance* of the lands and contracts to the Logging Company at the end of operations for the consideration of $1.00 (Tr. 132).

The Logging Company, on its part, agreed (Tr. 133) to log the timber on the lands described in the contract and deliver the logs to the Lumber Company

> "at its mill at Batterson or on cars at the logger's re-load at Batterson";

to construct a bridge across the Nehalem River. The Logging Company agreed to log a sufficient number of logs of the character required or desired by the Lumber Company for the use of its mill at Batterson; to keep in the log pond, a sufficient supply of logs to keep the Lumber Company's fill in continuous operation *on a one shift* basis.

In subparagraph (e), Tr. 134, the Logging Company gives to the Lumber Company, at all times,

> "the first right and option to purchase the entire output of the Loggers at the market price or the mill pond price as herein provided."

The Loggers agreed not to assign this contract, nor to assign, sell, or convey any of the lands or timber contract rights, or logging road rights, owned by the Loggers in the area covered by the contract except with the written consent of the Lumber Company.

It is then "mutually agreed" (Tr. 135) that the mill was constructed upon the agreement of the Loggers *"or their successors in interest"* to provide the logs needed to keep the Batterson Mill in continuous operation *"on a one shift basis"* and the "first right or option to purchase at the market price," all of the merchantable fir timber coming from the lands owned or controlled by the Loggers or by the Lumber Company,

> "for use in its plant at Tacoma or for use in its sawmill at Batterson."

The schedules attached to the contract describe the lands bought in part with the money "advanced" by the Lumber Company and conveyed directly to it (including the Belding tract) and the lands already owned by the Logging Company and conveyed to the Lumber Company as additional security. (Substantially the same as in the former contract.)

On May 10, 1948, a supplemental agreement was entered into (Pl. Ex. 2, Tr. 146). It refers to the agreement of January 8, 1948 (Pl. Ex. 1), and then recites:

> "Whereas, the Loggers desire to obtain a further 'advance' from the Lumber Company in the sum of $24,000.00 for the purpose of purchasing approximately 4,000,000 feet of fallen and standing merchantable timber from the Estate of H. E. Piatt, deceased, . . . together with certain logging equipment . . . and Whereas, the Lumber Company is willing to 'advance' the additional sum of $24,000.00 *to enable the Loggers to obtain the above described timber and logging equipment.* . . .

It is then agreed that the Lumber Company will "advance" to the Loggers, the cash sum of $24,000.00;

that the Loggers shall purchase all of the timber, referred to, with the logging equipment; that the Loggers shall obtain a bill of sale to the personal property and a "sufficient assignment of the cutting contracts" from the Estate of H. E. Piatt. It is then agreed that the Loggers will log the timber and give the Lumber Company

> "at all times the first right and option to purchase all of the logs produced from said land at the market price or mill pond price, as provided under the contract between the parties hereto dated the 8th day of January, 1948.";

that the Lumber Company shall deduct from the market price of the logs, as fixed by the earlier agreement, on all logs sold to the Lumber Company, $10.00 per thousand feet until the sum of $24,000.00 has been fully paid.

The Lumber Company did not exercise the option to purchase "the entire output of the logs'. The Lumber Company only purchased about one-half of the output (Tr. 299).

The Lumber Company did not purchase any peelers for the Tacoma plant or at all after June 1, 1949 (Tr. 301). The mill at Batterson was operated intermittently from the time of its completion in March 1948 to June 29, 1951, when it was shut down and was not put in operation until October 1, 1951 (Tr. 190-205).

At the time of the shut-down on June 29th, there was approximately one-half million feet of logs in the pond and on or about that date, an additional one-half million feet of logs were put into the pond at the Batter-

son mill, so that there was approximately a million feet of logs in the pond at the Batterson mill at the time of the shut-down and was available for processing when the mill was opened on October 1st.

Prior to September 1, 1951, the relationship between the parties was fairly satisfactory although the Logging Company complained about the Lumber Company's practice of reducing the prices on logs by questioning grades.

Instead of buying logs for the purpose of supplying peelers to its Tacoma plant and for the operation of the Batterson plant, it engaged in the business of selling the logs elsewhere and trading them for lumber, which was contrary to the purpose of the contract (Tr. 187, 214, 217, 320).

By June 1950, the Logging Company had paid to the Lumber Company all of the "advances" made by the Lumber Company for the purchase of timber, lands, and contracts, and for all other purposes, including interest thereon at the rate of 4% per annum (Finding 4, Tr. 87) and the Lumber Company had been reimbursed for all other expenses for attorneys' and title companies' fees, taxes, fire insurance, and so forth (Admitted, Tr. 285-286). From that date, the Lumber Company merely held the naked legal title to the properties in trust for the Logging Company.

The Lumber Company was not in possession of any of the properties at any time. They were in possession and control of the Logging Company and were being

logged by the Logging Company and by the Corporation after the sale September 1, 1951.

On September 27, 1951, Buol and Carr (Corporation) went to Tacoma and had an interview with the Lumber Company's Officers and Representatives. They informed them that the Corporation had acquired the Logging Company's interests and that they wanted to become acquainted with the customers who were buying logs from that operation and talked to them about purchasing the Batterson mill, or making some arrangements for the operation of the mill. They believed that because the mill had been shut down for a long period of time, that the Lumber Company would be interested in disposing of the mill or arranging for its operation. They were told that the day before, an arrangement had been made to sell the mill to a Mr. Gould, or the Diamond Lumber Company, which Mr. Gould owned or controlled. At that conversation, the Lumber Company's Representative called attention to the contract with the Logging Company and he inquired whether they were aware of the contract. When told that they were not, he produced the contract, which was examined. They stated that the contract would make no difference because they were there to sell the logs to the Lumber Company in any event (Tr. 340). *The Lumber Company's Representatives admit that Buol and Carr offered to sell them the logs and that they had come up for that purpose* (Tr. 258, 265, 373). A further conference was had the following day and consultations were had with Counsel for the Lumber Company with respect to the

contract, but the important fact is that the Lumber Company's officials did not then, or at any time thereafter prior to the commencement of this action, object to the transfer of the business by the Logging Company to the Corporation, nor did they claim that there was a violation of the non-assignment provision of the contract.

On the contrary, the discussions related to the continued sale of the logs from these timber lands to the Lumber Company. The Lumber Company complained that they had not received an invoice for one raft, which had been made up after the Corporation took over. Buol and Carr assured them that from that time on, there would be no trouble about invoices; that they intended to take over the business of invoicing themselves to avoid any delays or annoyances on that account.

At those two interviews, when Buol and Carr were informed that the Lumber Company was selling the mill to Gould, they were told that Gould would determine what logs he wanted and that they were to make arrangements with him regarding the logs for the Batterson mill (Tr. 375). Buol and Carr informed them that that was satisfactory to them. All they were interested in, was to sell the logs, but they wanted to know who would pay for the logs and they testified that they were told that they would have to look to Gould for the payment of the logs. Pohlman and Holm, Lumber Company Representatives, denied this and testified that they said that they would pay for the logs.

Within a few days thereafter, Gould and Buol and Carr discussed the matter of the payment for the logs

at the mill, or in the vicinity of the mill. They wanted to know about Gould's financial ability to pay for the logs. Gould tried to satisfy them of his financial ability and told them he had $150,000.00 available for that purpose (Tr. 331). They pointed out that that was insufficient to take care of the quantity of logs that would be produced according to their rate of production (Tr. 382). (Not contradicted by Gould.) It also developed that Gould wanted to have all logs, in excess of the amount which could be used at the Batterson mill, to be stored at another location or to be delivered to another mill which his Company owned.

In the meantime, log rafts were being scaled and the scale sheets were sent to the Lumber Company.

The plan of handling logs, as outlined by Gould, was unsatisfactory for another reason. Under the contract with the Lumber Company, peeler logs were to be selected and supplied to the Lumber Company for its use at its Tacoma plant. Peeler logs sell for a considerable amount in excess of the price of saw logs which are cut up into lumber. Under Gould's plan, all of the logs were to be delivered either at Batterson or at his own mill, or cold decked, and paid for as "saw" logs, which was not in accordance with the contract arrangements.

The sale of the Batterson Mill by the Lumber Company to Gould was not consummated, but an agreement was made between the Lumber Company and Gould that Gould should start the operation of the Batterson mill on October 1, 1951, for his own account; *that he was to receive all the profits* and *was to bear all of the*

losses that *might result from the operation of the mill,* and the Lumber Company would buy the logs for Gould as his agent (Tr. 230). The mill was thereafter operated on that basis.

The incident that precipitated this controversy involved the sale of raft No. 46. This raft was scaled September 4, 1951, after the Corporation took over the operations. The scale sheet shows that it was scaled for the account of the Corporation. The scale sheet was received by the Lumber Company on September 19th. Under the practice that had prevailed, the Lumber Company was to make out the invoice if it desired to exercise the option to purchase the raft. It had this scale sheet in its possession at the time of its interview with Buol and Carr on September 27th and 28th and had not yet exercised the option to purchase it. It exercised the option to purchase the raft on October 3, 1951, at which time the Lumber Company made out an invoice for that raft and sent it to the Logging Company (not the Corporation) with a remittance for the amount of the invoice, payable to the Logging Company. On October 9th, the Logging Company returned the remittance to the Lumber Company with a letter advising that the raft had been sold. The notation on the scale sheet shows that it was sold on October 3rd, which is the same day that the Lumber Company mailed the invoice and remittance to the Logging Company and was probably received a day or two thereafter. The transaction is shown by Plaintiff's Exhibit 4 (Tr. 154-156) which consists of the scale sheet, the check with the statement thereon, and the letter returning the check.

There was a delay from September 19th, when the Lumber Company received the scale sheet, to October 3rd, in exercising the option to purchase the raft, which was a much longer period than normal for exercising the option. The raft was sold after this delay, on the assumption that the Lumber Company did not intend to take the raft. The average time for exercising the option was a few days (Exhs. 12, 13, 14, 15).

The check was returned on October 9th and seems to have precipitated this litigation because the complaint was filed October 15th without further notice or communication (Tr. 6). It is highly significant that from September 27th, when the Lumber Company became aware that the Corporation had purchased the Logging Company's interests and was conducting the Logging operations, and October 15th, when the complaint was filed, that *the Lumber Company did not in any of the oral conversations had with Buol and Carr, or by any other communication, refuse to recognize the Corporation as the "successor in interest" of the Logging Company, or object to the transfer as being in violation of the non-assignment provision of the contract, but on the contrary, attempted to carry on business with the Corporation.* It insists that they were willing to pay for the logs that would be delivered to Gould and did itself, attempt to exercise the option to buy from the Corporation, raft No. 46 with the full knowledge that it had become successor in interest to the Logging Company. It is in no position, therefore, to urge the failure to obtain the *written* consent as a breach of the contract.

In any event, there is not a scintilla of evidence in the record that any damage resulted from the failure to obtain the written consent to the transfer. The only damage that is claimed in the case, allegedly resulted from the alleged failure to supply logs to the Batterson Mill.

The record establishes the transfer from the Logging Company to the Corporation was not made for the purpose of avoiding the option to the Lumber Company to purchase logs; that it was the intention that the successors in interest would continue to supply the logs; that they were desirous of doing so and went to Tacoma for that purpose to confer with the Lumber Company (Tr. 258, 265, 373).

The transfer of the mill by the Lumber Company to Gould introduced the controversy as to who should exercise the option to buy and pay for logs. While the discussions, arising from the introduction of Gould into the situation, were in progress and without any notice, this suit was initiated.

Other pertinent facts will be referred to and discussed later in connection with the specific assignments of error.

ARGUMENT

POINT I

The transaction described in the contract constitutes a loan of money by the Lumber Company to the Logging Company secured by conveyance to the Lumber Company of the timber lands and contracts described in the contract. The relationship was that of mortgagor and mortgagee and upon payment of the loans, the Lumber Company's interest in the timber lands terminated and thereafter it held the naked legal title in trust for the Logging Company, the beneficial owner thereof.

Practically all of the question presented upon this appeal, depend for their determination upon the construction to be placed upon the transaction described in the contract (Pl. Exh. 1).

It is well settled that in determining whether a transaction creates a mortgagor and mortgagee relationship or an absolute conveyance, all negotiations from the inception preceding and leading up to the contract in question, must be considered in order to arrive at the intention of the parties.

59 C.J.S., 77, Sec. 40, Title Mortgages.
Umpqua Forest Ind. v. Neenah-Oregon Land Co., 188 Or. 605, 217 Pac. 2d 219.

The genesis of the relationship between the parties goes back to 1943 (Tr. 280-281). McKenney was engaged in logging in a small way and the Lumber Company was purchasing logs from him. McKenney borrowed money from the Lumber Company with which to

carry on his operation. The loans were secured by chattel mortgages on his equipment (Tr. 281). He had a chance to purchase some timber land and he borrowed some money from the Lumber Company with which to make the purchase. The loan was secured by chattel mortgages on his equipment.

He then had an opportunity to purchase about 32,000,000 feet of green timber from the Belding Logging Company, which included timber contracts which Belding Logging Company had with Tillamook Yellow Fir Company. He obtained a contract for the purchase of those timber lands (Tr. 282-3). *These are the same timber lands involved in the present controversy.* By the terms of that contract, he was required to have all of the timber removed or paid for by December 31, 1946 (Tr. 282) or forfeit the contract.

After he engaged in logging that area for some time, it became apparent that he would not be able to complete the logging operations and pay for the timber by December 31, 1946. In that situation, he went to the Lumber Company

> "to get the money to buy this timber and the Lumber Company advanced some money to buy this timber." (Tr. 282).

This transaction was evidenced by a written contract dated May 22, 1946 (Def. Exh. 24, Tr. 556).

This contract was offered in evidence, but was rejected by the Court as "entirely immaterial" (Tr. 555). This ruling is assigned as error. We submit that this contract should have been admitted in evidence for it

involves the identical transaction and throws light upon the intention and purposes of the parties in entering into the contract now under consideration and should be considered in interpreting the latter contract.

59 C.J.S., page 77, sec. 40, Title Mortgages, says:

> "On the question whether a deed absolute in form was intended as a mortgage, it is proper to consider the previous negotiations of the parties, their agreements and conversations, and *the course of dealings between them prior to and leading up to the deed in question.*" (Emphasis supplied)

In the Umpqua case, supra, the Oregon Supreme Court held that in cases of this character, the Court should consider, among other things,

> "The conduct of the parties both before and after the transaction, insofar as such conduct prospectively and *retrospectively* throws light upon the intention of the parties at the time of the transaction." (Citing many Oregon Cases). (Emphasis supplied).

The earlier contract (Exh. 24, Tr. 556) was absolutely pertinent and material evidence to show the true intention of the parties. It demonstrates that from the inception the transaction was founded upon loans and *not* upon sales. Once a mortgage always a mortgage is the rule in equity. Exhibit 1 is actually a continuation or renewal of the first contract (Exh. 24) in a modified form and relates to the very property here involved.

We have already analyzed this contract of May 22, 1946. It is evident from the face thereof, that the Lumber Company merely loaned McKenney a part of the money that paid for the Belding and Tillamook Yellow

Fir Timber lands and that the title was conveyed directly to the Lumber Company to *secure the indebtedness.* He also conveyed to the Lumber Company other timber land and contracts which he owned as *additional security.* It is perfectly obvious from a reading of it, that it was, in legal contemplation a mortgagor and mortgagee transaction with all the incidents inherent in such relationship and involved the identical timber lands that are now in question.

The mill was not constructed during the period of time referred to in that contract.

The *contract, now in question* (Pl. Exh. 1, Tr. 125), is dated January 8, 1948. While the first contract was made with McKenney alone, the second contract was made with McKenney and his wife and Glaser and his wife, all as co-partners doing business as "McKenney Logging Company." Glaser and McKenney had been operating together for some years as co-partners. The contract of January 8, 1948, covers the same timber lands and is obviously a renewal or continuation of the earlier contract and, indeed, recites (Tr. 126):

> "Whereas for the past several years the Lumber Company and the loggers have by either written or oral contracts had an agreement . . . . ."

which clearly refers to the contract of May 22, 1946 (Exh. 24), and the earlier oral contracts. It makes the same recitation with respect to the contract by the Logging Company for the purchase of the Belding timber and so forth.

The essential recitations and contractual provisions, both with reference to the loan and the security, as well as the option to the Lumber Company to purchase logs, are, in essence, the same.

Summarizing the transaction in the light of the earlier transactions and contracts, it is as follows:

(a) The Lumber Company loaned to the Logging Company part of the money with which to purchase timber lands and acquire timber contracts and to build roads, a bridge, and to finance other operating costs.

(b) The Logging Company secured the loans by having the timber lands purchased in part with said loans, conveyed direct to the Lumber Company and, *in addition thereto, the Logging Company conveyed to the Lumber Company, timber lands and timber contracts which it owned and had acquired without the financial assistance of the Lumber Company.*

(c) The contract gives to the Lumber Company an option to purchase at market price, "all"—"entire output" of logs that the Logging Company would cut from all of said timber lands.

(d) The contract creates an absolute obligation to re-pay to the Lumber Company all of the loans "advanced" with interest thereon at the rate of 6% per annum.

(e) Payment was to be made by the Lumber Company deducting $3.50 per thousand from all payments which it was to make to the Logging Company for logs purchased by the Lumber Company until the full amount of the loans, including the loans for the purchase of timber, were paid in full, together with the interest thereon.

(f) *The contract provides that in the event all of the timber is removed from the timber lands in question and the Lumber Company has not been paid in full, the Logging Company was to remain liable for and pay the unpaid balance of the loans.*

(g) The Logging Company was required to pay, and did pay, all taxes, fire insurance, and other carrying charges in connection with the timber lands.

(h) The Logging Company paid to the Lumber Company the attorneys' fees for the services rendered in connection with the purchase of the timber land. and the Logging Company paid the title policy fees.

(i) Throughout the entire transaction, the Logging Company was deemed to be the owner and seller of the logs removed from the timber lands and the Lumber Company the purchaser thereof.

(j) In June 1950, more than a year prior to the alleged default, the Logging Company paid the Lumber Company in full for all "advances" and loans made by the Lumber Company, together with the full amount of interest therein which, in legal contemplation, terminated the mortgagor-mortgagee relationship and the Logging Company became the equitable owner of the timber lands and the contracts and the Lumber Company was merely the holder of the naked legal title in TRUST for the Logging Company.

(k) Upon completion of the logging operations, all of the timber lands were to be re-conveyed by the Lumber Company to the Logging Company for the consideration of $1.00.

Taking the contract by its four corners in the light of the preceding contract (Exh. 24) and the earlier oral contracts, the transaction consists of two distinct parts:

(1) a mortgagor and mortgagee relationship which terminated when the loans were paid in full, and (2) an option by the Lumber Company to the Logging Company to purchase "all" of the logs produced by the Logging Company at market price.

This was the situation (assuming, without admitting, that the option survived and was not otherwise abandoned by the Lumber Company) when the Logging Company sold its interests in the timber lands to the Corporation.

The Court below held that the transaction was not a loan and security transaction, and we submit that this was clearly an erroneous determination when viewed in the light of the authorities hereafter referred to.

Each of the circumstances or factors referred to above individually, are entirely consistent with the mortgagor-mortgagee transaction, and taken collectively, a money lending transaction, and there can be no doubt that the relationship of the parties was that of a mortgagor and mortgagee.

We have in this case the anomolous situation where the Lumber Company claims ownership of the timber lands which, as a matter of law, would carry with it ownership of the timber thereon, and yet it is purchasing timber cut into logs from the Logging Company and paying the Logging Company the market price therefor. In other words, according to its own version, it is buying its own timber and paying therefor at the market price. This is obviously an incongruous position.

The creation and subsistence of the obligation to repay the loans with interest in any event, even after the timber was removed, is in itself conclusive of the relationship of debtor and creditor and mortgagor and mortgagee.

The conveyance by the Logging Company to the Lumber Company of *its own timber lands and timber contracts,* which it had acquired with its own resources, clearly constituted *additional security*. There is no consideration for the conveyance of those timber lands to the Lumber Company except as security. The transaction cannot be split up into two parts so as to say that the timber lands, conveyed to the Lumber Company which was purchased in part with the "advances", was an absolute conveyance and the conveyance of the Logging Company's own timber lands was security,

It is recognized by the Courts in this class of cases that borrowers in distressed conditions or acting under some business compulsion, will submit to exacting demands when applying for loans and where the lender insists on conveyance of the title to property, subject to defeasance upon payment of the loans, that the transaction will be deemed, in equity, to be a mortgage transaction with all of the incidents inherent therein.

In this case, the transaction had its origin in applications for loans. As already pointed out, prior to the contract of May 22, 1946, McKenney was borrowing money from the Lumber Company and the loans were secured by chattel mortgages. After the Belding and Tillamook Yellow Fir timber lands were purchased on contract, the

Logging Company found itself in a distressed condition. It was up against a date line. Payment in full of the balance had to be made by December 31, 1946. It was known that this payment could not be made and this resulted in an application to the Lumber Company for a loan with which to pay the balance of the purchase price. The Logging Company was under economic pressure and coercion at the time and it had to submit to the exaction of having the timber lands conveyed direct to the Lumber Company and, in addition thereto, to convey their own lands to the Lumber Company as additional security.

Under the authorities that will be presently cited, the fact that a transaction originates in an application for a loan and the borrower is under compulsion, is a most important circumstance pointing to the true character of the transaction.

In the *Umpqua case,* supra, the Oregon Supreme Court held that the use of the term "advance" is "most significant."

In *Roesch v. Equitable Savings & Loan Association,* 176, Or. 7, the Oregon Supreme Court held that the term "advance" "implies a loan."

To the same effect, see *Carney v. Murphy,* 195 Pac. 2d 339; *Brock v. Fidelity Deposit Co.,* 75 Pac. 2d 605.

The fact that title to part of the timber lands and contracts were transferred by the vendor direct to the Lumber Company, does not preclude the transaction from being a loan and a mortgage transaction.

36 Am. Jur., 751, Sec. 128.
Hall v. O'Connell, 52 Or. 164, 95 Pac. 717.
Conley v. Henderson, 158 Or. 309, 75 Pac. 2d 746.

It is the rule that *any doubt* as to the character of the transaction should be resolved in favor of a mortgage transaction.

Conley v. Henderson, supra;
Harmon v. Grants Pass Banking Co., 60 Or. 69;
Ringer v. Virginia Timber Co., 213 Fed. 1001.

The facts in this case come squarely within the principles recognized and applied in the following cases:

Stanley Dollar et al. v. Land, Chairman, United States Maritime Commission, 184 F. 2d 245, cert. denied, 340 U.S. 884;
Hall v. O'Connell, 52 Or. 164, 95 Pac. 717;
Umpqua Forest Industries v. Neenah-Oregon Land Co., 188 Or. 605, 217 Pac. 2d 219;
Harmon v. Grants Pass Banking & Trust Co., 60 Or. 69;
Conley v. Henderson, 158 Or. 309, 75 Pac. 2d 746, regarded by the Oregon Supreme Court as the leading case on the subject;
Ringer v. Virgin Timber Co., 213 Fed. 1001.

The pertinent facts and excerpts from the decisions in these cases are set forth in the Appendix, pages 1 to 8.

In 36 Am. Jur. 751, Section 128, Title Mortgages, the text says:

> "Moreover, an instrument of conveyance intended to secure the performance of an obligation, although not in the form of a mortgage, may be interpreted as constituting the obligor a mortgagor even though the obligor is not a party to the conveyance, where, at the time thereof, he had a mort-

gageable interest in the property or, by virtue thereof, acquired such interest and, by his act or assent, procured the execution of the conveyance to the grantee therein. Thus, it has been adjudged that where one who has a contract for a conveyance of land procures the execution of the deed to another as security for a debt, the transaction constitutes a mortgage.

. . . . .

"Sec. 143. Effect of lack of Identity Between Grantor and Obligor.—An instrument of conveyance intended to secure the performance of an obligation, although not in the form of a mortgage, may be interpreted as constituting the obligor a mortgagor even though the obligor is not a party to the conveyance, where, at the time thereof, he had a mortgageable interest in the property or, by virtue thereof, acquired such interest, and by his act or assent procured the execution of the conveyance to the grantee therein. In such case, parol evidence is admissible to show that the transaction was intended as a mortgage; the rule that a deed absolute on its face may be shown by parol to be a mortgage does not generally depend for its application on the circumstance that the grantor in the deed and the alleged mortgagor are one and the same person. Thus, it may be proved by parol that a deed was given to the grantee therein, not to vest in him the full title, but to secure the repayment to him of sums he had advanced to a third person to be used by such third person in purchasing for himself the property conveyed."

The facts in the case at bar are in the essential particulars the same as in the cases just cited. The true character of the transaction must be determined without regard to the language of the contract which purports to make the Lumber Company a purchaser of the property and the owner thereof. "We must look at the essential

nature of the transaction and not play upon phrases" (*Dollar* case). Here, too, the Logging Company submitted to the type of security demanded or required by the lender, namely, the transfer of the title purchased in part with money "advanced" by the lender and the transfer of title to the borrowers' own property, so that legal title to all of the property was vested in the lender instead of the usual procedure of giving a mortgage to secure the loans.

Here, too, the transaction was devised and the documents drawn by Mr. Neal, an able lawyer of a prominent Tacoma law firm, who was himself interested in the Lumber Company. He was the president thereof and executed all three contracts on behalf of the Lumber Company.

In *McPherson v. Hayward,* 17 Atl. 164, 165 (Me.), the Court held:

> "Where one has a contract for a conveyance of land to him and procures another to complete the payments for him, and such other person does so and takes the deed in his own name as security for his advances, the transaction constitutes a mortgage of the land between the parties. Stoddard v. Whiting, 46 N.Y. 627; Carr v. Carr, 52 N.Y. 251; Houser v. Lamont, 55 Pa. St. 311; Smith v. Cremer, 71 Ill. 185."

In *Campbell v. Dearborn,* 12 Am. Rep. 671, 682 (Mass.), the Court held:

> "In the present case, we are able to arrive at the clear and satisfactory conclusion that there was no real purchase of the land by the defendant, either from Tirrill or from the plaintiff; that his advance of the purchase-money at the request of the plain-

> tiff created a debt upon an implied assumpsit, if there was no express promise; and that it was the expectation of both parties that the money would be repaid soon and the land reconveyed. Whatever may have been the intention of the defendant, he must have known that this was the expectation of the plaintiff; and it is most favorable to him to suppose that it was his own expectation also. These conclusions are not in the least modified in his favor by an examination of his answer."

Under these authorities there is no escape from the conclusion that the parties were mortgagor and mortgagee with all the legal incidents inherent in such relationship; that when the debt was paid in June 1950, the mortgagor-mortgagee relationship terminated; that the Lumber Company was not the owner of the property, but merely held the naked legal title in trust for the Logging Company or its "successors in interest" and when the Logging Company, and the Corporation thereafter, cut and removed timber therefrom, it was their own timber, being the equitable and beneficial owners thereof, and that all that remained of the contract (unless abandoned) was an option to purchase logs after they were cut at market price.

POINT II

The Court erred in rendering judgment against the Logging Company and the Corporation for the sum of $50,000.00, the value of logs alleged to have been removed by them. The Lumber Company was not the owner of the logs. They were owned by the Logging Company or the Corporation. The Lumber Company only had an option to purchase the logs at market price.

If the Court determines that the transaction, described in the contract under consideration, was a loan of money secured by a transfer of the title to the timber lands and contracts and that the relationship was that of mortgagor and mortgagee, then it follows, as a matter of course, that the Logging Company or its transferee, the Corporation, was the owner of the timber lands and the logs removed therefrom; that the Lumber Company was not the owner of the logs removed therefrom, and it merely had an option to purchase the logs at market price.

The mere fact that the Lumber Company held the naked legal title to the lands IN TRUST for the Logging Company, did not make it the beneficial owner of the logs as against the true owner. The logs were the property of the Logging Company or its successor, the Corporation, and in removing them, they violated no property right of the Lumber Company.

If the removal of the logs and the sale thereof to others constitutes a violation of the Plaintiff's option to

purchase the logs, it would only give rise to an action for damages and not for the value of the logs.

In *Caro v. Wollenberg,* 68 Or. 420, 136 Pac. 866, title was conveyed by deed as security for indebtedness and the grantee went into possession, the Court held that the deed which was in equity a mortgage, and

> "After a mortgagee has received payment of his debt, he really holds the property in trust for the mortgagor: 2 Jones, Mortgages, Section 1159."

In *Caro v. Wollenberg,* 83 Or. 311, 163 Pac. 94, involving the same transaction, the Oregon Supreme Court called attention to Section 335 L.O.L. (now Section 86.010 Oregon Revised Statutes), which provides as follows:

> " 'A mortgage of real property shall not be deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property without a foreclosure and sale according to law.' "

And the Court went on to say:

> "This section is an emphasis of the principle that a mortgage does not convey title."

This principle was applied in that case where a deed was held to be a mortgage in equity.

It is obvious that the Lumber Company was not the owner of the property conveyed to it as security, either before or after payment of the debt, and certainly had no beneficial interest therein after the indebtedness was paid in full long prior to the time of the alleged removal of the timber.

The Lumber Company cannot recover the value of the property it did not own as against the true owner thereof.

These Appellants adopt the argument in the brief of Appellant McKenney Logging Corporation under Point II, pp. 16 to 22.

POINT III

The Court erred in rendering judgment against the Logging Company and the Corporation in the sum of $118,000.00 for alleged loss of profits resulting from the alleged failure to furnish logs for the operation of the Batterson Mill.

(a) It was error to render judgment in favor of the Plaintiff and against the Appellants for the sum of $118,000.00 loss of profits resulting from the alleged failure to supply logs for the operation of the Batterson Mill because the contract only required furnishing of logs sufficient to operate the Batterson Mill on a *one shift* basis and the record establishes, by the Plaintiff's own witnesses, that the mill had sufficient logs to operate on a one shift basis during all of the time in question, and was actually operating during that time.

(b) Even if loss had been sustained, the Plaintiff is not entitled to recover the same for it is not the real party in interest. It had transferred the operation of the mill to Roy Gould (Diamond Lumber Company) under a contract by which Roy Gould was to have all of the profits from the operation of the mill and was to absorb all losses.

(c) There is no competent evidence that the Batterson Mill could have been operated at a profit.

(d) There was, in fact, no refusal to sell logs for the operation of the Batterson Mill. The Corporation offered to supply logs for the operation of the mill, but the Lumber Company and its transferee, Gould, attempted to impose conditions not warranted by the contract.

Re Alleged Loss of Profits

The only damages claimed and allowed in the Court below as a result of the alleged breach of the contract, was the loss of profit ($118,000.00) for failure to sell logs to the Lumber Company for the operation of the Batterson Mill.

The contract only obligated the Logging Company to supply logs sufficient to operate the mill on a *one-shift basis* (Tr. 134, subdiv. (d) and Tr. 135, subdiv. (a)). The testimony of Gansberg, the Lumber Company's Representative in charge of "procuring logs for the operation of the mill at Batterson," testified, unequivocally, that Plaintiff was able to get enough logs to operate the mill on a one-stift basis (Tr. 469-471).

It was conceded in the Court below that no damages were sustained if the Logging Company was only obligated to supply logs for a *one-shift operation*. On page 7 of Plaintiff's Supplementary Brief, submitted in the Court below, Plaintiff's Counsel said:

> "Plaintiff concedes that if the sole duty of defendant partnership under the contract was to supply

sufficient logs for a one-shift operation, no damages were sustained during this period, because it is not contended that plaintiff was compelled to pay a premium price to Nehalem and Smith & Wright, nor does plaintiff contend at this time that any logs have been taken from property subject to the Buffelen-McKenney contract since January 16, 1952."

This point is discussed and the evidence pertaining thereto is referred to in Point IV, pp. 24 and 25 of the Brief of Appellant McKenney Logging Corporation.

The argument is hereby adopted by the Appellants Glaser & Glaser.

Re Real Party in Interest

Since the Lumber Company transferred the operation of the mill to Gould under agreement that Gould was to have the profits and absorb the losses from the operation of the mill, the Lumber Company cannot, in any event, have any recovery, whether of profits or losses.

Appellants Glaser and Glaser adopt the argument under Point V, p. 26 of the Brief of McKenney Logging Corporation, which presents this contention.

We merely wish to supplement the argument by reference to the following testimony which bears on the question as to whether Plaintiff sustained any damage from the alleged failure to supply logs. Roy Gould, who operated the mill after October 1, 1951, under the contract that he was to receive all the profits and sustain all losses from the operation of the mill, testified that he

bought logs for the operation of the mill from other operators (Tr. 221). (He did not testify that he had to pay any more for the logs than he would have had to pay to the Lumber Company or the Corporation.) He attributed losses among other things to the "breaking in of new men and getting an organization started." He also testified (Tr. 221-222) that he bought logs from Yunker in October and November 1951 (Tr. 225), but did not testify to the payment of any increased amount.

Re Failure to Establish that Batterson Mill Could Have Been Operated at a Profit

The only evidence introduced by Plaintiff in support of its contention that it sustained loss from the failure to supply logs for the operation of the Batterson Mill, consisted of summaries or tabulations made up by Plaintiff's accountant for use upon the trial. They were admitted in evidence over objection of the Defendants and the admission of these summaries or tabulations is assigned as error. Without these summaries or tabulations, there is not a scintilla of evidence in the record to sustain a finding that the mill could have been operated at a profit on a one shift basis and the summaries, even if admissible, do not sustain such a finding.

The admissibility of these summaries (Exhibits 19-A, 19-B, and 19-C, and Exhibit 22), are discussed under Point VI, pp. 27 to 30 of the Brief of Appellant McKenney Logging Corporation and are also discussed in the Brief of Appellants McKenney and McKenney. Appellants Glaser and Glaser adopt the same arguments.

Re Alleged Refusal to Sell Logs

There was, in fact, no refusal by the Corporation, after it became the owner of the Logging Company's interest in the timber lands, to sell logs to the Lumber Company or to Gould, its transferee. Buol and Carr both testified that they went to Tacoma for the express purpose of arranging for the sale of logs to the Lumber Company (Tr. 353). Holm, the Lumber Company's Representative, testified (Tr. 258) that Buol and Carr told them that they came to Tacoma to sell them logs. The testimony of all of the witnesses, (Plaintiff's and Defendants') as to the conversations that took place on September 27th and 28th in Tacoma, shows that Buol and Carr went there to sell them the logs and that all of the discussions pertained to the manner and place of delivery, as well as the discussions as to the transfer of the mill to Gould, and that Buol and Carr were told that they would have to deal with Gould (See excerpts from testimony and discussions at pages 62 to 68 of this brief).

POINT IV

The Court erred in holding that there was a breach of the contract by reason of the sale by the Logging Company of its interests in the timber lands and contracts to the Corporation without the written consent of the Lumber Company.

It is, of course, true that the Lumber Company did not give its "written"consent to the transfer of the Logging Company's interest in the timber lands to the Corporation.

But it does not follow that the making of the transfer without such "written" consent constitutes a breach of the contract resulting in a forfeiture of the Logging Company's timber lands to the Lumber Company or that the transfer constituted a breach of the contract at all for the following reasons:

(a) The contract does not provide for any forfeiture in the event of sale without the written consent of the Lumber Company;

(b) The Lumber Company did not object to the sale and acquiesced therein;

(c) The transfer, without written consent, is not the real basis of this action.

(d) No damage resulted from the failure to obtain the "written" consent prior to the transfer to the Corporation because the Corporation was willing to recognize the option to purchase logs and to sell logs to the Lumber Company on the terms of the contract.

A.

While the contract contains a provision prohibiting transfer of the timber lands without the "written" consent of the Lumber Company, it is *not coupled with any provision for any forfeiture* or other penalty.

It is well settled that a provision prohibiting assignment of a contract without written consent, creates no forfeiture in the event of a violation of the provision. It merely gives the party to the contract the privilege of rejecting the assignee and may be waived expressly or impliedly by the conduct of the parties and by acquiescence in the transfer.

In *Nielsen v. Baldridge,* 173 Or. 555, 567, 146 P. 2d 754, the Oregon Supreme Court held:

> "The contract, although affording the plaintiff the privilege of rejecting assignees, contained no provision which forfeited the contract in the event of an unauthorized assignment."
>
> . . . . .

The Court then quotes from *Johnson v. Eklund,* 72 Minn. 195, as follows:

> " 'It will be noted that there is no provision that an assignment without Eklund's written approval should forfeit the contract, or give the vendor the right to declare it forfeited; and certainly the courts will not read any such right into the contract by implication. There is nothing personal in the nature of the contract. All that the vendor was interested in was the payment of the purchase money at maturity. If he received this, it was wholly immaterial to him who paid the money or who got the land. At most, this stipulation against an assignment is *merely collateral* to the main purpose of the contract, designed as a means of securing an enforceing performance of what was undertaken by the vendee, to wit, the prompt payment of the purchase money. When the vendor has received all his purchase money, he has received all that he is entitled to, and all that the provision against an assignment was intended to secure. Under such circumstances, the fact that the assignment to plaintiff was not countersigned by the vendor is no defense to an action by her to compel a conveyance.' " (Emphasis supplied)
>
> . . . . .
>
> "The following, said in Griff v. Landis, 21 N.J. Eq. 494, is much quoted:
>
> " 'But I apprehend such collateral covenant will never be thus enforced, where it appears upon the face of the contract that the prohibition to assignment is *not the main purpose of the covenant, but*

> *a mere incident to a security for such purpose.* It is the province of a court of equity to ascertain what is, in truth, the real intention of the parties, and to carry that into effect.
>
> . . . . .
>
> "We know of no reason whatever for not applying in this suit the principles which controlled the cases from which we have just quoted. The contract before us has not been terminated." (Emphasis supplied)

Under these principles, it is clear that the mere failure to obtain the written consent of the Lumber Company to the transfer of the Logging Company's interest in the timber lands to the Corporation, did not vest any title to the timber lands in the Lumber Company or create in it any property right or in any way affect the beneficial ownership of the timber lands in the Logging Company or in its successor, the Corporation.

Since the non-assignment provision was merely collateral to the option to purchase logs and since the Corporation was willing and offered to sell logs to the Lumber Company on the terms of the option, the Lumber Company did not object to the Corporation becoming the purchaser, the failure to obtain in advance the "written" consent did not constitute a breach of the contract.

The only remedy available to the Lumber Company for the transfer of the property without its written consent, is an action for damages if it sustained any by reason of the transfer, provided, of course, it had not waived the requirement or acquiesced in the transfer by its conduct.

The record establishes that the Lumber Company did not object to the transfer of the timber lands by the

Logging Company to the Corporation when informed thereof; that it acquiesced in the transfer; that it undertook to transact business and was willing to transact the business contemplated by the contract with the Corporation. The failure to obtain the written consent was never asserted by the Lumber Company as a breach prior to the commencement of this action and is not the real foundation for this action.

The transfer by the Logging Company to the Corporation was made in the early part of September 1951. The Lumber Company became aware of the transfer on September 27, 1951, when Buol and Carr (the Corporation) went to Tacoma and informed Pohlman and other officers of the Lumber Company, that they purchased and had become the owners of the Logging Company's interest in the timber lands and timber contracts. Conversations were had between Buol and Carr (the Corporation) and Pohlman and other representatives of the Lumber Company, including its attorney and president, on September 27th and 28th.

There is no evidence in the record that anyone on behalf of the Lumber Company objected to the transfer during those conversations or that the Corporation would not be recognized as the transferee or that the Lumber Company would refuse to do business with the Corporation.

On the contrary, the discussions that took place, clearly indicate a willingness to recognize and do business with the Corporation as the successor to the Logging Company and many subjects were discussed on the assumption that the Corporation would be so recognized.

Edward M. Buol testified that after the Corporation acquired the Logging Company's interest in the timber, he and Carr, who constituted the Corporation, went to Tacoma on September 27, 1951, and talked to Pohlman and Holm, officers of the Lumber Company (Tr. 328). They first talked about purchasing the Batterson Mill. They were told that a deal had been made with Gould (Tr. 329). They offered to sell the logs to the Lumber Company. Pohlman told them that Gould was taking the mill and that they would have to deal with Mr. Gould and make arrangements with him to sell the logs to him (Tr. 330). They discussed four rafts of logs which were in process of completion about ready for delivery. They were told that

> ". . . we would have to deal with Mr. Gould; he would be the man that would buy the logs." (Tr. 331)

At that conversation, Pohlman read the contract to Buol and Carr (Tr. 337). At the conversations that took place on September 27th and 28th, Buol and Carr were requested to put logs in the mill at Batterson (Tr. 339).

Carr testified that at that conversation, he told Pohlman that they had taken over the McKenney Logging Company and some arrangements could be made to buy the mill or take it over (Tr. 350). Pohlman told him that they had made arrangements with Gould and that Gould would take care of things from then on (Tr. 350). He was asked whether they knew of the contract with the Logging Company and when he said that he had never seen it, Pohlman got the contract and read it to him. Carr said that the contract wouldn't make any dif-

ference because he intended to sell them the logs and told him that he had four rafts that were in the course of completion (Tr. 351). Pohlman told him that Gould would be buying the logs and they had turned the whole business over to Mr. Gould (Tr. 351). Pohlman asked them to go up and see Mr. Neal, the attorney and president of the Lumber Company. *Carr testified that no objection was made at that time to their taking over the Logging Company's holdings* (Tr. 352). At that conversation, they discussed the matter of making out invoices and Carr told Mr. Holm that they would make out the invoices instead of the invoices being made out by the Lumber Company as was theretofore done (Tr. 352). Holm told Carr that that would be a good arrangement,

"much better than what they had." (Tr. 352)

Pohlman and Holm made arrangements for Buol and Carr to meet with Gould and they did meet on the following day (Tr. 353). Gould said he was going to operate the plant and open it up pretty soon and was going to take on all of the logs they had *and wanted them dumped in the Batterson Mill pond*. This conversation was in the presence of Holm and Pohlman. Carr told Pohlman at that time,

> " 'That doesn't make any difference to us where you want them. We don't care.' I says, 'I want to sell you logs as long as you pay for them.' I says, 'I don't care where you deliver them or where you want them put. We don't care.' " (Tr. 353)

They then discussed the rafts which were then being made up in the river and he was told by Holm and

Gould that they could go ahead and complete the rafts that were in the river, but *they didn't want the rafts that were in the river* (Tr. 354). He offered those rafts to them at the time as he wanted to go on doing business with them (Tr. 355). Gould said he didn't want raft 46-M because it was in the river. Gould told them to go ahead and sell the raft (T. 355). This was not denied. The conversation of the 28th of September was held at the office of Mr. Neal, the attorney and president of the Lumber Company. Mr. Neal inquired as to who was the attorney for the Corporation. He was told, he was Mr. Tracy Griffin and Mr. Neal told them,

> " 'We won't have any trouble getting together on this . . . . . 'I will call Tracey up or Tracey can call me up, or vice-versa,' he says, 'and we will get together.' " (Tr. 357)

Carr asked Mr. Neal,

> " 'Well, what should we do in the meantime?' He says, 'just go on like you are. You will hear from us in a day or two.' (Tr. 358)

He never heard from Mr. Neal thereafter.

Mr. Frank C. Neal, the Lumber Company's president and attorney, testified with respect to that interview that he inquired as to who the lawyer for the Corporation was; that he learned it was Mr. Tracey Griffin, and then testified:

> "Q. What, if anything, did you say when they told you who their lawyer was?
>
> A. I said I had known Tracy Griffin well for many years, and if Tracy Griffin was their lawyer I was sure that he and the lawyer for Mr. Gould, with whom I was in touch at that time and in

negotiations, could easily work out all the angles of their trouble." (Tr. 381)

He testified that he was representing the Lumber Company; that Andrew Koerner was representing Mr. Gould and when asked the purpose of having the conference between the three, he answered:

> "Because in my opinion a harmonious relationship between all the parties was very essential, and *the idea was to arrange for the consent by Buffelen Manufacturing Company, to consent to the taking over by the new people of the McKenney contract, and also at the same time to obtain the consent, the written consent, of the new people as assignees of the McKenney people to the taking over of the other contract by Mr. Gould* on whatever conditions were brought up at that time." (Emphasis supplied)

After that conversation, further conversations were had between Buol and Carr and Gould at the mill in reference to the delivery of logs, the manner of storing and payment therefor.

Pohlman testified that on the first day of that interview, he made arrangements for Buol and Carr to meet Gould; that he told Buol and Carr that Gould would operate the mill after October 1st and that *Gould would tell them what logs to dump in the pond.* Pohlman pointed out that if the deal with Gould went ahead,

> "the thing that would make a success of any operation would be cooperation between the logger and the mill operator."
>
> "Q. If you did eventually sell it, would you be concerned about the relations between *Gould and Buol and Carr?*
>
> A. Yes, we would.
>
> . . . . .

Q. Did you tell *Mr. Buol and Mr. Carr* that Mr. Gould was going to operate the mill after October 1st?

A. That is correct.

Q. Who was to tell *Mr. Buol and Mr. Carr* what logs were to go in the pond and what logs were not to go in the pond?

A. Mr. Gould." (Tr. 375) (Emphasis supplied)

Pohlman complained about some former delays in invoicing the rafts. The matter was discussed and he testified:

"Mr. Carr assured him (Holm) at that time that as soon as they took over and got into this thing this thing would not occur again; that the way they operated they would issue invoices promptly." (Tr. 376)

Mr. Holm, the representative of and witness for the Lumber Company, testified that prior to October 1st, he had already talked to *Buol and Carr about selling the logs to Gould* and that it was their intention to sell the mill to Gould (Tr. 225). He testified that he *told Buol and Carr where to dump logs* at the interviews of September 27th and 28th (Tr. 257-258). He also testified that at that conversation, *Buol and Carr told them that they came to Tacoma wanting Buffelen as a customer* (Tr. 258).

"Q. At that time you testified that you informed them to dump logs in the millpond?

A. Yes, that is right." (Tr. 259)

Roy Gould, the party to whom the Lumber Company intended to sell the mill and who operated the mill after October 1st, testified as a witness for the Lumber Company that he met with Buol and Carr on September

28th in conjunction with Pohlman and Holm; that he discussed the supply of logs with Buol:

> "Everything was very harmonious. He agreed that he would promptly start supplying the mill with logs." (Tr. 229)

He then testified that Pohlman and Holm told Buol and Carr that he was about to purchase the Batterson Mill.

> "Q. And that they should sell the logs to you if you purchased the mill; is that right?
>
> A. That is right; that they would keep the contract on the timber and be responsible for it in every way and the contract would carry on regardless of whether I bought the mill or not." (Tr. 230)

At the conversation of September 27th, Buol and Carr agreed to deliver logs (Tr. 232).

No one testified on behalf of the Lumber Company that any objection was ever made orally or in writing to the transfer of the Logging Company's interests in the timber lands to the Corporation.

There is direct testimony by Carr (uncontradicted) that no such objection was ever made.

The foregoing specific testimony, and the record as a whole, demonstrates very clearly that the controversy does not arise out of the fact that a written consent to the transfer was not obtained prior to the transfer; that the Lumber Company and Gould acquiesced in the transfer and carried on negotiations which are consistent only with such acquiescence. It included agreements which could only be made upon the recognition of the Corporation as the assignee, such as agreements for the

delivery of logs to Gould and agreement as to where logs were to be dumped, and so forth.

The testimony of Mr. Neal is of the highest significance. It demonstrates that it was contemplated that the transfer would be confirmed by subsequent written consent not only as to the transfer from the Logging Company to the Corporation, but also the sale of the mill by the Lumber Company to Gould. There was to be reciprocal consent affirmative of what had already been done and it is obvious that the failure to obtain the written consent to the transfer prior thereto, was not deemed to be and, cannot now, be retroactively treated as a breach of a contract.

The controversy does not stem from the failure to obtain the written consent. It stems from a misunderstanding between the parties as to who was to pay for the logs that were to be delivered to Gould. The Corporation was concerned over this matter of payment and who was to make the selection of logs. They believed that it was the intention of the Lumber Company that the Corporation should look to Gould for payment of the logs. They believed him to be under-financed and were reluctant to accept Gould as the obligor (Tr. 331).

It was while this misunderstanding was being looked into and before any attempt to resolve it was made, that this law suit was commenced on October 15, 1951 (Tr. 6).

Under these circumstances, the failure to obtain the "written" consent to the transfer, cannot be treated as a breach of the contract.

POINT V

The Court below erred in holding that the Lumber Company had a subsisting option to purchase logs from the Logging Company's timber lands at the time of the alleged breach. The record establishes that the Lumber Company had, in fact, abandoned the purpose of the contract.

In September 1951, at the time of the alleged breach, the Logging Company had paid to the Lumber Company, in full, all of the indebtedness, including the interest thereon.

As a matter of law, the Lumber Company's interest as mortgagee in the said timber lands had terminated in June 1950 when the loans were re-paid.

The question remains, did the Lumber Company have a subsisting option to purchase logs thereafter?

We submit that the record establishes clearly that the purpose of the contract, insofar as it involves the option to purchase logs, had been abandoned by the Lumber Company.

The contract in question has three parts:

(a) Conditions to be performed by the Lumber Company;

(b) Conditions to be performed by the Logging Company;

(c) Mutual agreements.

The contract, insofar as it provides for an option to buy logs, is found in subdivision (e) of the Logging Company's obligations (Tr. 134), as follows:

"(e) To give to the Lumber Company at all times the first right and option to purchase the *entire output* of the Loggers at the market price for the mill pond price as herein provided." (Emphasis supplied)

And in the mutual covenants (Tr. 135), which provides:

"(a) That the Lumber Company has constructed its sawmill at Batterson in full reliance upon the agreement on the part of the Loggers or their *successors in interest* to provide the logs needed to keep the Lumber Company mill in continuous operation on a one shift basis and in the further reliance upon the agreement on the part of the Loggers to give the Lumber Company the *first right or option* to purchase at the market price, as herein defined, *all* of the merchantable fir timber coming from the lands either owned or controlled by the Loggers or by the Lumber Company *for use in its plant at Tacoma or for use in its sawmill* at Batterson." (Emphasis supplied)

The record establishes an abandonment of the option and purposes of the contract for the reasons:

(1) The Lumber Company did not elect to purchase "all" or "the entire output of the Loggers." The evidence establishes that only about 50% of the Logging Company's output was purchased by the Lumber Company.

(2) The Lumber Company did not purchase any peeler logs or other logs for the Tacoma plant.

(3) A substantial part of the logs that were actually purchased, were not for use in the Tacoma or Batterson Mills, but was sold or traded by the Lumber Company for lumber.

(4) The Lumber Company's transfer of the mill for operation by Gould subjected the Logging Company or its successor to the imposition of conditions in reference to the selection of logs, place of loading, and delivery, by Gould instead of the Lumber Company and for purposes other than contemplated by the contract.

We respectfully invite attention to the following testimony:

Holm, the Lumber Company's Representative, testified (Tr. 181), that in conversation with McKenney, he said:

> "We want all the logs that were produced . . . . .
> Q. Was that all logs or all *saw* logs?
> A. All *saw* logs." (Emphasis supplied)

This, of course, excluded the peeler logs.

At Transcript 187, he testified:

> "Q. Do I understand correctly, then, that you purchased logs that were put in the river and *sold those logs to other persons?*
> A. That is right, *on a trading basis.*
> Q. Would you explain that further?
> A. Yes. It is the practice for mills that only use part of the materials out of the logs to trade them to mills to get the materials that they will need or what the logs will produce. Rather than ship all the commons to Tacoma, we tried to *put the logs into different mills* and receive the shop or peelers, *or whatever we might use, for trading purposes.*
>
> . . . . .
>
> Q. In other words, you were dealing in logs, then, on the Columbia River in the year 1951?
> A. Well, I don't know how you put that dealing in logs. We were buying McKenney's logs and

turning them over to one of our people that furnished shop lumber for us at Tacoma.

Q. Who was it you turned the logs over to?

A. Columbia River Paper Mills.

Q. You sold those logs to the Columbia River Paper Mills?

A. That is right.

Q. Now, you received in exchange peelers for them?

A. Some peelers and some shop lumber." (Tr. 188)

. . . . . .

"A. Why was it that on May 22nd you directed Mr. McKenney to dump all sawmill logs at Batterson?

A. To what?

Q. To dump all sawmill logs.

A. At Batterson?

Q. At Batterson.

A. I didn't do that on May 22nd.

Q. What did you tell him to do?

A. I told him that we wanted all the sawmill logs that he was hauling to the river.

Q. Where did you want them?

A. Well, we were going to take them at the river.

Q. You wanted them at the river?

A. Well, we would accept them at the river where he was dumping and rafting them.

Q. That was for the purpose of trading in those logs in the river?

A. That is right.

Q. And that was the sole purpose?

A. What is that?

Q. The sole purpose of requesting all logs after that date at the river was to trade those logs in the river?

A. For materials for our plant at Tacoma." (Emphasis supplied)

Mr. Bradeen, the Lumber Company's assistant manager, testified that in 1950 no logs were shipped to Ta-

coma. The rafts numbered 6-M to 16-M inclusive were unloaded at Batterson (Tr. 199).

Mr. Bevan, the Lumber Company's assistant log buyer, testified that they were buying peeler logs at Longview Washington, in 1950. No reason is assigned why they didn't buy peeler logs from the Logging Company.

James Chamberlain, the Lumber Company's assistant superintendent of the Tacoma plant, testified that in May 1951, they were taking some grades of logs at the mill at Batterson, but not all grades (Tr. 214); that the Lumber Company wanted logs for "trading purposes"; that all the logs could not be used at the Batterson Mill and Tacoma was not taking any saw logs, and that the purpose of purchasing logs that could not be used at the Batterson Mill was

> "to be traded for products that we needed." (Tr. 217)

Glaser testified (Tr. 320) that the reason they sold raft 44 was that it was a "peeler raft" and

> "up to that time, why, Buffelen had not been interested in peelers . . . . . They were not interested in peelers in the Columbia River at that time. They had not been since—well, they never had bought any peeler rafts out there." (Tr. 320)

The evidence also establishes that upon the transfer of the mill to Gould, that *he* was to determine what logs would be taken; that is to say, he would exercise the option; that it would be his choice or selection and not that of the Lumber Company for the specific purposes contemplated by the contract. Gould himself testified

that it was his intention to utilize the logs in part for the Batterson Mill and in part for his own mill located at Tillamook. He also wanted all logs without segregation into peelers (which have a higher market price) and saw logs. The peelers would have to be cut up into saw logs because there was no plywood mill at Batterson. This arrangement introduced new conditions affecting the market price of the logs and the selection of logs and other factors affecting the profitable disposition of the logs.

This course of procedure is wholly at variance with the purpose expressed in the recitals in the contract and in the contractual provisions.

It is also apparent from the record that while it was contemplated that the Batterson Mill should have a continuous operation, its operation was spasmodic and it had many shutdowns and was shutdown entirely from June 29, 1951, to October 1, 1951.

We submit that this course of conduct on the part of the Lumber Company constitutes an abandonment of the purposes contemplated by the contract and of the option to purchase "all" or "entire output" of the logs. The Logging Company was justified in its belief that the Lumber Company had abandoned the option after the shutdown of the Batterson Mill for three months.

This was a reasonable belief because the *contract did not specify any particular times or periods in which the option was to be exercised, or to what extent it would be exercised in a given period,* with the result that the Logging Company could find itself, and did at times

find itself, with large inventories of logs without knowing when, if ever, the Lumber Company would elect to buy them. Certainly, after a lapse of more than two years in failing to purchase logs for the Tacoma mill, the Logging Company had a right to assume that the purpose of the contract had been abandoned, at least, to that extent.

POINT VI

The Court below erred in granting equitable relief because the case presents no ground of equitable cognizance. The plaintiff had an adequate remedy at law for a breach of the contract, if any there be.

The contract has two distinct phases: (a) a loan secured by conveyances of property which are, in legal effect, mortgages, and (b) an option to the Lumber Company to purchase logs from the Logging Company at market price.

The first phase of the contract terminated when the loans were paid off. The Lumber Company ceased to be a mortgagee in equity and, thereafter, held the naked legal title to the property IN TRUST for the Logging Company.

There remained only the phase of the contract which gave the Lumber Company the option to purchase logs.

That option to purchase logs after the timber was cut and made into logs (personal property) *created no property right,* either in the lands from which the timber was to be cut, or in the timber standing thereon, or in the logs cut therefrom.

James on Options, Sec. 502, p. 200, says:

> "No interest in land is acquired until the optionee exercises his right to purchase, and a provision that the option shall be a covenant running with the land does not alter the rule."

The writer illustrates the principle as follows, p. 201:

> "Thus, where the lessor of a brick yard leases the same reserving as rent a certain sum on every thousand bricks manufactured by the lessee, and the lease giving him the option, from time to time, to take, at the kiln, at the market price, such quantity of bricks as should be equivalent to the sum named as rent, the lessor had no property in the bricks till he made his election." (Citing Appeal of Wait, 24 Mass. 100.)

An option is not a contract at all. It is merely an offer and does not ripen into a contract until acceptance.

An option without consideration, like any other offer, may be withdrawn before acceptance.

An option given for a consideration, is merely an agreement to keep the offer open for a stipulated period of time. It creates no property right or interest in the property which is the subject matter of the option. When the owner of the property disposes of it in violation of an option to purchase, it can only result in a cause of action for damages, if any there be, for failure to keep the option open for the stipulated period of time. Since the holder of an option has no interest in the property, a Court of Equity is without jurisdiction to restrain the owner from selling the property.

In the case at bar, assuming that the Lumber Company had a subsisting option to purchase logs, a Court

of Equity could not *enjoin* a sale of the Logging Company's equitable interest in the timber lands by the Logging Company and it certainly had no jurisdiction to cancel a sale of the property *after* a sale is consummated.

The remedy of the optionee would, in any event, be limited to the recovery of damages for failure to keep the option open. *This is an adequate remedy at law.*

In *Herndon v. Armstrong,* 148 Or. 602, the Oregon Supreme Court held that an option to purchase property

> "created no interest in the property described in the contract."

In *The Texas Company v. Butler, et al.,* 198 Or. 368, 256 Pac. 2d 259, the Court held:

> "Such a contract (option to purchase) does not pass to the optionee, so far as the option alone is concerned, any interest in the land until a valid election to buy has been made, in accordance with the terms of the option, which then changes the character of the parties from optioner and optionee to vendor and purchaser. *Herndon v. Armstrong,* 148 Or. 602, 608, 36 P. 2d 184, 38 P. 2d 44; *Richanbach v. Ruby,* 127 Or. 612, 630, 271 P. 600, 61 A.L.R. 1441; *Strong v. Moore,* 118 Or. 649, 245 P. 505."

In *Kingsley v. Kressly,* 60 Or. 167, 111 Pac. 385, 118 Pac. 678, the Oregon Supreme Court held that an optionee to purchase property, even when the option is for a valuable consideration,

> "would acquire no right in the property."

Assuming, without admitting, that the sale of the timber lands by the Lumber Company to the Corpora-

tion, constituted an interference with Plaintiff's option to purchase logs, it would not warrant the exercise of equity jurisdiction because the Lumber Company would then have an *adequate remedy at law* for such interference, assuming that it suffered damage.

The sole consequence that would result from the failure to keep the option open, if it be a fact, would be that the Lumber Company would have to purchase logs elsewhere and perhaps be required to pay more than the market price, which was the basis of the purchase price under the contract, and the diffierence would be the measure of damage recoverable in an action at law.

In *Sweeney v. Smith,* (cited and discussed in the Brief of Appellant McKenney Logging Corp., pages 8 to 11), a case involving the unlawful inducement to breach a contract for the sale of securities, the District Court held:

> "It will also be observed, in the examination of the cases referred to, that, where an actionable wrong has been suffered by unlawful interference with a contract, the form of action to redress the injury is a suit at law. The proceeding here is in equity, and, while it is not necessary (if I am right in what I have heretofore said) to decide that the complainant has an adequate remedy at law, it may not be improper to add that this ground of demurrer by Smith & Co. would deserve serious consideration if it required decision."

In *Strong v. Moore,* 105 Or. 12, 207 Pac. 179, the Oregon Supreme Court held:

> "An option confers a privilege or right to elect to buy, but it does not impose any obligation to buy. (Citing cases.)

> "An option does not pass to the optionee any interest in the land . . . . . and therefore a person appearing in the character of an optionee possesses nothing except the right to elect to buy, and he has no interest in the land until by his acceptance of the option he transforms the option into a contract of sale and changes his character from that of an optionee to that of a vendee." (citing cases)

In *Leadbetter v. Price,* 103 Or. 222, 202 Pac. 104, the Oregon Supreme Court held:

> "It is only after the optionee has made an election under the terms of the option agreement, and within the time limited thereby, or by the law, where no time limit is fixed by the agreement, that an executory contract of sale result, of which a *court of equity will require the specific performance.*" (Emphasis supplied)

In the case at bar, there was only an outstanding option to the Lumber Company to purchase logs (assuming that it had not been terminated). The option had not been converted into a contract by an election to exercise the option. The contract contemplated election in the future as and when logs were produced. Hence, there was no property right enforceable by suit in equity.

The decree, insofar as it cancelled the deeds (Tr. 96) was clearly erroneous for want of equitable jurisdiction. The bare option to purchase logs in the future, which in the very nature of things could only be exercised in the future as and when logs were produced, would not authorize a decree in equity cancelling the conveyances from the Logging Company to the Corporation. This is particularly true because the Corporation recognized the

option when it was called to its attention and was at all times willing to sell logs to the Lumber Company on the terms of the option.

In James on Option Contracts, Sec. 1123, p. 536, the writer says:

> "An optionee may not maintain ejectment against the grantee of the option during the running of the option and before election, as no title or interest in the property passes to the optionee."

The decree cancelling the conveyances are, in legal contemplation, analogous to a judgment of ejectment referred to in the text. It accomplishes the same purpose and cannot be sustained because of the lack of a property right in the optionee.

In Section 1126, p. 541, the same author, in dealing with the subject of equitable remedies available to an optionee, says:

> "When it appears from the bill the agreement under which an option on mineral rights is claimed is not mutual so that specific performance will not be decreed against the optionor, the optionee is not entitled to an injunction to restrain the optionor from selling the mineral rights to a third person . . . . ."

Here, again, is reaffirmance of the principle that the holder of a bare option, which has not ripened into a contract by acceptance or the exercise of the option, has no standing in a court of equity and that if the optionor has, in violation of the terms of the option, parted with the property which is the subject matter of the option, the only remedy would be at law for damages.

It is, of course, elementary that equitable remedies will not be available where there is a lack of mutuality. This is, of course, true in the case at bar because the Lumber Company was not obligated to buy the logs. It merely had an option to purchase. The Logging Company could never have compelled the Lumber Company to buy and its failure to exercise the option at any time with respect to any part of the logs, would not have resulted in any cause of action in favor of the Logging Company. There was obviously a lack of mutuality, which is the first pre-requisite to the allowance of equitable remedies.

CONCLUSION

For the reasons herein and in the brief of the Appellant McKenney Logging Corporation, the judgment and decree must be reversed and the complaint dismissed.

Respectfully submitted,

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APPENDIX

In *Stanley Dollar, et al. v. Land, Chairman, United States Maritime Commission,* 184 F. 2d 245, certiorari denied, 340 U.S. 884, (a case with which this Court was also concerned) the plaintiffs transferred capital stock of the corporation to the Maritime Commission. Plaintiffs claimed that the stock was transferred as security for loans. The Maritime Commission claimed that the transfer was absolute in satisfaction of plaintiff's obligations to the Maritime Commission. The Commission realized more than enough to pay the loans in full from the operation of the corporation's steamships. The District Court held the transaction to be an absolute transfer. The Court of Appeals, reversed that decision, and held:

> "Because of the power which a creditor has over his debtor, especially a distressed debtor, equity views with considerable skepticism claims by the creditor of rights beyond the right to security and repayment. Pomeroy states the matter thus:
>
> " 'This doctrine is based upon the relative situation of the debtor and the creditor; it recognizes the fact that the creditor necessarily has a power over his debtor which may be exercised inequitably; that the debtor is liable to yield to the exertion of such power; and it protects the debtor absolutely from the consequences of his inferiority, and of his own acts done through infirmity of will. The doctrine is universal in its application, and underlies many special rules of equity.'
>
> *"Equity tends strongly to treat as mortgages or pledges transactions* between debtors and creditors relating to property of the debtors; even conveyances absolute on their face may be treated as

mortgages if in fact they were security for and not satisfaction of the debt. Pomeroy, citing many cases, describes the 'general criterion * * * established by an overwhelming consensus of authorities,' 'the practical test,' 'the sure test and the essential requisite.' This criterion is the continued existence of the debt. Pomeroy says: *'If there is an indebtedness or liability between the parties,* either a debt existing prior to the conveyance, or a debt *arising from a loan made at the time of the conveyance,* or from any other cause, and *this debt is still left subsisting,* not being discharged or satisfied by the conveyance, but the *grantor is regarded as still owing and bound* to pay it at some future time, so that the payment stipulated for in the agreement to recovery is in reality the payment of this existing debt, then the whole transaction amounts to a mortgage, whatever language the parties may have used, and whatever stipulations they may have inserted in the instruments.' "

. . . . .

"Here again we must look at the essential nature of the transaction and not play upon phrases." (Emphasis supplied)

In Oregon, it is well settled that transactions of this character are deemed to be mortgages, and that the rights and liabilities of the parties are governed by the principles applicable thereto.

The rule is the same *where the borrower is the owner of the property conveyed to the lender* as it is where property is being purchased in whole or in part with money advanced by the lender and the granter conveys title directly to the lender.

In *Hall v. O'Connell,* 52 Or. 164, 95 Pac. 717 plaintiff entered into a contract with one Mrs. Schetter to

purchase from her certain real property. He was unable to make the payment of the purchase price. Defendant advanced the money with which to pay the purchase price and by agreement between plaintiff and defendant, Mrs. Schetter executed the deed to the property, naming the defendant as grantee. Thereafter, plaintiff tendered to defendant the repayment of the purchase price. Defendant refused to accept the same and asserted ownership to the property. Plaintiff brought the suit to declare the deed to be a mortgage. The Trial Court rendered a decree in favor of the defendant, but the Supreme Court reversed the decree and held:

> "a deed absolute on its face given as security for the repayment of a loan may be shown by parol to be intended in fact as a mortgage. This has been frequently so decided by this court, beginning with *Hurford v. Harned,* 6 Or. 362. But it is urged by the defendant that this is a purchase by defendant with his own money and a conveyance to him from the vendor and not from the plaintiff, and therefore does not come within the above rule, and is within the statute of frauds. But as we understand, the rule that a deed absolute on its face, given as security, may be shown by parol to be a mortgage, applies equally to the case of a purchaser borrowing the purchase money, and causing the title to pass directly from the vendor to the creditor as security for the loan.
>
> "It is a question of the intention of the parties and not the form of words or of the instrument. If the equitable interest in the property is in the debtor, equity will protect him. In such a case, Jones, Mortgages, says, at section 331: 'The grantee in such case acquires title by his (the debtor's) act, and as security for his debt, and therefore holds the title as his mortgagee.' Also 27 Cyc. 979, says: 'If a

person who has contracted for the purchase of land procures another to lend him the money necessary to make the payments, or to advance it for him, and has the deed made to the latter, with an agreement that he will convey the title to the former on repayment of the amount advanced, the transaction will amount to an equitable mortgage, if it was the understanding and intention of the parties, that the one should become debtor to the other for the money advanced, and that the land should be held merely as security for his debt. If this was their contract, the form in which they may have cast the agreement is immaterial.'

. . . . .

" . . . So, when the fact is determined that the loan was made by defendant to the plaintiff, and that the deed was so taken as security therefor, then it is established that the purchase was made in defendant's name with plaintiff's money, and *when the debt is paid* defendant holds but the naked title without any beneficial interest, and is deemed the trustee of the title for the plaintiff. It is so held in many cases on this subject." (Emphasis supplied)

In *Umpqua Forest Industries v. Neenah-Oregon Land Company, et al.,* 188 Or. 605, 217, Pac. 2d 219, a case involving the question whether a transaction was a loan with security, the Court held:

"A deed absolute on its face may be shown to be a mortgage. The classic statement of the equitable principles underlying this rule is formulated by Pomeroy as follows:

. . . . .

" 'If the instrument is in its essence a mortgage, the parties cannot by any stipulations, however, express and positive, render it anything but a mortgage, or deprive it of the essential attributes belonging to a mortgage in equity.'

. . . . .

" 'This doctrine is based upon the relative situation of the debtor and the creditor; it recognizes the fact that the creditor necessarily has a power over his debtor which may be exercised inequitably; that the debtor is liable to yield to the exertion of such power; and it protects the debtor absolutely from the consequences of his inferiority, and of his own acts done through infirmity of will. The doctrine is universal in its application, and underlies many special rules of equity. * * *' Pomeroy's Equity Jurisprudence, Vol. 4, 5th Ed., § 1193."

. . . . .

"Our decisions establish that if the intent appears that property was conveyed and received as security for the fulfillment of an obligation, the form of the instrument becomes immaterial and the true nature of the transaction may be shown by parol evidence. Neither fraud, mistake nor accident need be proven. The primary inquiry relates to the intention of the parties at the time the transaction was consummated. *Harmon v. Grants Pass Banking & Trust Co.,* 60 Or. 69, 118 P. 188. Mutual intent is to be determined, not alone by the instruments executed, but also by the attendant circumstances and the conditions under which the instruments were delivered. The issue can be resolved only after considering the situation of the parties, the prices fixed relative to the value of the property and the conduct of the parties, both before and after the transaction, insofar as such conduct prospectively or retrospectively throws light upon the intent of the parties at the time of the transaction. (Citing many Oregon cases.)

. . . . .

"The use of the word 'advance' is most significant, ...

. . . . .

"The fact that negotiations originated out of an application for a loan tends to support the conclu-

sion that the deed given was intended as a mortgage.

. . . . .

"O'Neill and his company were certainly in straightened circumstances when he sought the loan and when he closed the deal on 6 February. It is established that *continued possession of property by the grantor is some evidence that the conveyance was intended as a mortgage.* 1 Jones on Mortgages, 8th Ed., § 402, p. 496; 5 Tiffany, Real Property, 3d Ed., § 1396, p. 263. The provision permitting the Plywood Company to log the tract during the period of purported option presents an analogous situation."

. . . . .

" ' . . . . evidence of a doubtful import will be construed in favor of the theory that a mortgage was intended, so that in such case a deed with a provision for a reconveyance will be construed as a mortgage rather than as a conditional sale. * * *' 36 Am. Jur., Mortgages, § 173, p. 776." (Emphasis supplied)

In *Harmon v. Grants Pass Banking & Trust Co.,* 60 Or. 69, the Court held:

"Based on these considerations, the rule has been established in equity that *where doubt exists* as to whether the deed evidences a conditional sale or a mortgage, the uncertainty will be resolved in favor of a conveyance designed as a security for the payment of money." (Emphasis supplied)

In *Conley v. Henderson,* 158 Or. 309, 75 Pac. 2d 746, a case in which the loan was made to enable the borrower to complete the purchase of the property and the title was conveyed to the lender, the Supreme Court, in determining that the transaction was a mortgage, held:

"It is a fundamental principle of equity that whenever a conveyance of land is given for the purpose of securing payment of an existing debt it is a mortgage. And whatever may be its form,

" 'If the instrument is in its essence a mortgage, the parties cannot by any stipulations, however express and positive, render it anything but a mortgage, or deprive it of the essential attributes belonging to a mortgage in equity.'

. . . . .

"As was said by Mr. Justice Story in Flagg v. Mann, 2 Sum. 486, 533 (Fed. Cas. No. 4,847):

" 'If a transaction resolves itself into a security, —whatever may be its form,—it is in equity a mortgage.'

"To the same effect is 1 Jones, Mortg. (8th Ed.), section 294. And, as stated by Pomeroy, in section 1237, 'the form is immaterial if the intent appears to make any identified property a security for the fulfillment of an obligation.' "

In *Ringer v. Virgin Timber Co.,* 213 Fed. 1001, the Clio Lumber Company was the owner of a sawmill and valuable timber lands which were subject to a mortgage. The mortgage was being foreclosed. The Lumber Company applied to a Company called Illinois Realization Company for a loan with which to pay off the mortgage loan. The Realization Company refused to make the loan, but arranged for a representative of that corporation to purchase the property at foreclosure sale. Thereafter a corporation was formed which took over the title to the property at a sum in excess of the amount paid on the foreclosure proceedings, the purchase price to be secured by mortgages made by the corporation. The corporation then agreed to convey the

property to the former owner for the increased amount. The question arose whether the transaction was a purchase and sale agreement or a loan with security in the nature of a mortgage transaction. The representatives of the Realization Company always referred to the transaction "as a purchase of the property and a sale at a good profit". The Court held the transaction to be a mortgage and not a sale and said:

> "But regardless of the language used in the negotiations as descriptive of the transaction, if the transaction was in substance merely a device for the purpose of evading the usury laws, the plea must be sustained, for the law does not tolerate any device to avoid the consequences of unlawful acts. The authorities are unanimous that the courts will disregard the form which a contract may take, but look to the substance of the transaction in order to determine whether or not it is usurious. The books contain many cases where artful contrivances have been resorted to whereby the lender is to receive some other advantage or something of value beyond the repayment of the loan with legal interest."
>
> . . . . .
>
> "From time immemorial needy borrowers have consented to any terms imposed upon them, and in the opinion of the court the realization company was organized for the very purpose of taking advantage of the necessities of such persons."

No. 14188

In the

United States Court of Appeals

For the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

APPELLEE'S BRIEF

in Answer to Brief of Appellant
McKenney Logging Corporation

Appeals from the United States District Court
for the District of Oregon

HONORABLE JAMES ALGER FEE, Chief Judge

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JURISDICTION

This is a suit in equity for injunctive relief and incidental damages brought in the United States District Court for the District of Oregon by appellee Buffelen Manufacturing Co. (hereafter called "Buffelen"), a California corporation, against Edward M. Buol, a citizen of Washington, appellant McKenney Logging Cor-

poration, a Washington corporation (hereafter called "the corporation"), J. B. Carr, a citizen of Oregon, and appellants Bart and Marie McKenney and Einar and Dorothy Glaser, citizens of Oregon. The amount in controversy exclusive of interest and costs exceeds $3,000.00 (Tr., pp. 10-11, 86).

Said appellants have appealed from the final Judgment and Decree of that Court (Tr., pp. 95-96, 107-108, 115-116).

The District Court acquired jurisdiction under 62 Stat. 930, 28 U.S.C.A. §1332. This Court acquired jurisdiction under 62 Stat. 929, 28 U.S.C.A. §1291.

APPELLEE'S STATEMENT OF THE CASE

The statement which follows is supplemented by the statements contained in appellee's briefs in answer to the briefs of appellants McKenney (at pp. 4-5) and Glaser (at pp. 5-18).

On January 8, 1948 Buffelen Lumber & Manufacturing Company and appellant partners (McKenney and Glaser) entered into a written contract which is set forth in the transcript at pp. 125-146. It provided that the partners should log certain timber described in the contract (Tr., pp. 133, 142-146). Buffelen owned part of the timber, and the partners owned or had log-

ging rights over the remainder (Tr., pp. 126-127, 142-146). It further provided that Buffelen should have an option on the partners' total output (Tr., p. 134).

A Supplemental Agreement relating to other lands subsequently bought by the partners was entered into between the same parties on May 10, 1948. It is set forth in the transcript at pp. 146-150.

All right and interest of Buffelen Lumber & Manufacturing Company under said contracts was assigned to appellee Buffelen Manufacturing Co. with the consent of the partners on June 30, 1948 (Tr., pp. 151- 153, 164-171).

Pursuant to the contract (a) appellee completed a sawmill at Batterson, Oregon at a cost of $150,000.00 which commenced operation in March, 1948; (b) appellant partners logged timber from the lands described in the contract; and (c) between January 8, 1948 and September 1, 1951 appellee purchased 55,546,171 feet of logs produced by said appellants for $2,490,991.88 (Tr., pp. 11, 391).

The contract of January 8, 1948 specifically provided that the partners would not

> "* * * assign this contract nor * * * sell or convey any of the lands or timber contract rights or logging road rights owned by the Loggers in the area covered by this contract except with the written

consent of the Lumber Company." (Tr., pp. 134-135)

In the late spring of 1951, appellant partners considered selling their operations and holdings in Tillamook County to Portland Manufacturing Company. The proposed sale collapsed when Buffelen would not sell its mill or give its consent (Tr., pp. 12, 294-298, 365-367, 450-455; Exh. 51).

On or about August 31, 1951, without notice to appellee, appellants McKenney and Glaser attempted to sell, assign and transfer their operations, holdings and interests in Tillamook County, Oregon, including the timber land and cutting rights described in the contract of January 8, 1948 (a large part of which then stood and still stand of record in Buffelen's name) to appellant McKenney Logging Corporation (Tr., p. 12). Appellants McKenney and Glaser admitted that neither of them advised appellee of the proposed sale (Tr., pp. 303, 175-176, 173-174). Appellee first acquired knowledge thereof at Tacoma, Washington, on September 27, 1951 when Messrs. Buol and Carr, principal officers of the corporation, called on Messrs. Holm and Pohlmann, appellee's Vice-President and raw material buyer, respectively, and advised them of the sale (Tr., pp. 258, 372-373).

The contract of January 8, 1948 also provided that the loggers should

> "* * * give to the Lumber Company at all times the first right and option to purchase the entire output of the Loggers at the market price or the mill pond price as herein provided." (Tr., p. 134)

Raft 44M was scaled August 15, 1951. Appellants McKenney and Glaser failed to give plaintiff the option to buy this raft. The scale sheets were received by appellee on August 20, 1951. No invoice on this raft was ever received (Tr., pp. 319-320). It was inspected by Mr. Gansberg, an employee of appellee, on August 23, 1951, and Mr. Holm informed appellant Glaser on August 24, 1951 that plaintiff wished to purchase it. Mr. Glaser then advised Mr. Holm that the raft had already been sold to others. *Mr. Holm then advised him that Buffelen wanted all peeler logs until further notice.* Raft 44M was the first which contained green peelers from the Yellow Fir Timber, which then stood and now stands of record in Tillamook County, Oregon in Buffelen's name (Tr., pp. 182-185, 307, 313, 319-320; Exh. 12).

Buffelen also instructed appellant McKenney on Sepember 21, 1951 to dump saw logs in the Batterson pond so that the mill (which had been temporarily shut down on June 29, 1951) could resume operation (Tr., pp. 250, 304).

Appellants thereafter refused to let appellee purchase Raft 46M, for which it tendered its check in full payment on October 3, 1951 (Tr., pp. 154-156, 259-270, 306). This tender was made to the partners after Buffelen had received knowledge of the attempted sale at Tacoma on September 27, 1951, at which meeting it had demanded Raft 46M and instructed Buol and Carr to deliver logs at Batterson (Tr., pp. 229, 259-260, 339, 376). Mr. Harry Reed, then employed by appellant McKenney Logging Corporation and formerly an employee of the partners, received the tender for Raft 46M and dictated the letter dated October 9, 1951 rejecting the tender and returning appellee's check. The letter was signed by defendant McKenney (Tr., pp. 277, 305, 364). McKenney Logging Corporation had not then sold said raft to any one else. It was not disposed of until October 22, 1951 (Tr., pp. 358-359).

Tracy Griffin, a Seattle, Washington lawyer who organized and represented McKenney Logging Corporation (Tr., pp. 383-384, 501) examined the deeds, contracts and cutting rights that defendants McKenney and Glaser purported to own or control (which included the land standing of record in appellee's name) prior to the attempted sale or conveyance of August 31, 1951 (Tr., pp. 272, 510).

Harry Reed, a principal employee of the partners, had full knowledge of the contract of January 8, 1948 at all times prior to August 31, 1951, and was familiar with the option contained therein in Buffelen's favor. When the attempted sale was made on August 31, 1951, Mr. Reed immediately assumed a similar position with McKenney Logging Corporation, and he still held that position at the time of the original trial (Tr., pp. 277, 364).

In September and October, 1951 logging contractors Healy and Magnuson operated a logging show for appellant corporation in Section 6, Township 2 North, Range 7 West and in Section 12, Township 2 North, Range 8 West of the Willamette Meridian, which tracts then stood and now stand of record in Buffelen's name (Tr., pp. 512-513, 161-162, 222-223). Two million feet of green and burned timber were removed therefrom during that period, the stumpage value of which was $25.00 per thousand (Tr., pp. 512-513, 223).

Appellee had requested river delivery of all saw logs on May 22, 1951 (Tr., pp. 180-181, 206, 213, 251, 309-310) and had bought all saws logs thereafter (Tr., pp. 186-187), even after it temporarily closed the Batterson mill on June 9, 1951 (Tr., pp. 12, 480) as permitted by the contract (Tr., pp. 138, 190-191). Appellant McKenney was advised by Mr. Holm on September 21,

1951 (before appellee knew of the purported sale) that the Batterson mill would reopen October 1, 1951, and he was instructed to dump logs in the pond at Batterson so that the mill could start operating (Tr., pp. 250, 304). When defendants Buol and Carr advised Buffelen of the purported sale to appellant corporation on September 27, 1951 they were instructed to start dumping logs in the pond at Batterson (Tr., pp. 229, 259-260, 339, 376). They promised to do so at once (Tr., pp. 229; Gl. Br., p. 60). On November 3, 1951, November 23, 1951 and December 24, 1951 the corporation was instructed to dump all logs in the Batterson pond (Tr., pp. 242-244). No logs were dumped in the pond at Batterson by either the partners or the corporation, and the Batterson mill, which had reopened in October, 1951 under the management of Roy Gould, was finally closed down in late November, 1951 (Tr., pp. 220-222, 227, 231-233, 234).

The corporation claimed to have taken the timber free of Buffelen's rights (Tr., p. 382), and Buffelen was thereafter refused the rights to buy logs unless it undertook to buy all that might be produced (Tr., pp. 262, 341-344, 347).

When the mill reopened on October 1, 1951 it was operated by Roy Gould, who was considering the purchase of the mill for $250,000.00 (Tr., pp. 219, 237). Buol and Carr were informed in Tacoma on September

28, 1951 that Mr. Gould would be operating the mill, but that Buffelen would continue to be the purchaser of the logs. No sale had yet been made (Tr., pp. 230, 254-256, 372-376). Buffelen would have retained an interest in the contract in the event of a sale by reason of its agreement with Mr. Gould to buy all shop lumber produced at the mill (Tr., pp. 253, 255-256, 375). Mr. Gould's operation was handicapped by lack of logs and he lost money because no other logs were available. He ceased operations in late November, 1951 after sustaining substantial losses (Tr., pp. 221-222, 226-227). He never bought the mill (Tr., p. 230).

It was contemplated that all parties would consent to any sale which might be made to Mr. Gould (Tr., pp. 383-384; Gl. Br., p. 61).

In the operation of the Batterson mill, appellee realized an average monthly profit of $9,000.00 during fiscal year July, 1949 to June, 1950 and $6,000.00 during fiscal year July, 1950 to June, 1951. Between December 1, 1951 and October 31, 1952 it sustained operating losses in the amount of $30,533.00 (without considering profits it would have earned had logs been delivered as required by the contract) in its attempted operation of the Batterson mill, although the market price of lumber was constant and strenuous efforts to secure an alternative log supply were made by Buffelen's employees

(Exhs. 19a, 19b, 19c, Appendix to McK. Br., pp. 47-52; Tr., pp. 221, 462-475, 480).

QUESTIONS PRESENTED

The following points are presented and argued by the corporation in its brief:

1. Is McKenney Logging Corporation liable for damages suffered by Buffelen in the operation of its mill at Batterson, Oregon after December 1, 1951? (Points I and III, Corp. Br., pp. 2-16, 23)

2. Did the court properly enter judgment against the corporation for treble the value of timber removed by it from Buffelen's land? (Point II, Corp. Br., pp. 16-22).

3. Does the evidence support the judgment for damages suffered by reason of the failure to deliver logs at Batterson? (Points IV, V and VI, Corp. Br., pp. 24-34).

ARGUMENT

I.

The trial court properly held the corporation liable for damages sustained by Buffelen in the operation of its mill at Batterson, Oregon after December 1, 1951 (Appellant's Points I and III).

SUMMARY

A. The facts.

B. The corporation is liable in tort for having schemed to effect a breach of the contract of January 8, 1948.

C. Erroneous assertions by appellant corporation.

D. There was abundant evidence of damage.

A. The facts.

The record shows conclusively that this is not a mere case of business competition in which one party to a transaction knows that the other party has made a prior and inconsistent contract. Appellant corporation denies liability solely on the theory that mere knowledge of the prior inconsistent contract is insufficient to render it liable for wrongfully interfering with that contract.

The trial court found as follows (Tr., pp. 88-89):

"X.

"Defendant McKenney Logging Corporation cut and removed over 2,000,000 feet of timber from plaintiff's land after September 1, 1951, of the value of $25.00 per thousand board feet and plaintiff sustained $50,000.00 damages by reason thereof.

"XI.

"Defendant McKenney Logging Corporation had knowledge of the contract, which is Plaintiff's Exhibit 1, prior to September 1, 1951, and its acts in cutting and removing timber from plaintiff's land were wilful and intentional.

* * * * * * *

"XIII.

"Plaintiff sustained damages in the amount of $118,000.00 by reason of McKenney Logging Corporation's interference with and inducing defendants McKenney and Glaser to breach the contract which is Plaintiff's Exhibit 1.

"XIV.

"Defendant McKenney Logging Corporation refused to tender to plaintiff for purchase all logs removed by it from the lands and rights covered by the contract which is Plaintiff's Exhibit 1."

For reasons discussed elsewhere (Br. Ans. Br. Gl., pp. 19-20), these findings are entitled to great weight.

The court concluded (Tr., p. 93):

"XII.

"Defendant McKenney Logging Corporation is liable to plaintiff for treble or three times the damages sustained by it and specified in Finding of Fact X in the total amount of $150,000.00 for intention-

ally trespassing upon plaintiff's land and wilfully and intentionally cutting timber therefrom and for $118,000.00 damages as specified in Finding of Fact XIII, for interfering with the contract, which is Plaintiff's Exhibit 1, between plaintiff and defendants McKenney and Glaser and for inducing a breach thereof."

The timber was listed by appellants McKenney and Glaser with Mr. Errion during the negotiations regarding the proposed sale to the Portland Manufacturing Company (Tr., pp. 441-443). The transaction between the partners and Messrs. Buol and Carr was originally designed to be a straight commission sale, and Mr. Matott and Mr. Errion were to share in the brokers' commission. However, it was thereafter agreed that Matott and Errion should share equally in the unissued stock of the proposed corporation following the conclusion of whatever litigation might result (Tr., pp. 406-407).

The evidence offered at the retrial established that E. R. Errion, who promoted this transaction, and defendants Buol and Carr, who are respectively the President (Tr., p. 326) and Secretary (Tr., p. 346) of appellant corporation, not only knew of the existence of the Buffelen contract, *but schemed with Mr. Errion and the partners to commit a fraud on Buffelen by agreeing to misstate the facts in an effort to destroy Buffelen's rights in the timber.* (See Br. Ans. Br. Gl., pp. 15-18).

At meetings attended by Mr. Errion, Mr. Carr and Mr. William J. Prendergast, formerly the attorney for the partners and the corporation in this lawsuit, it was concluded that the contract could be successfully avoided if the purchaser denied any knowledge of it. Mr. Prendergast advised that only in this manner could Buffelen's rights be destroyed (Tr., pp. 395-396, 404, 416-418, 431).

At that time, the supposed purchaser was Mr. Buol (Tr., p. 405). Thereafter, Mr. Buol and Mr. Carr organized the corporation and they both became principal officers thereof (Tr., pp. 326, 405, 406, 501, 504-505). They have at all times denied any knowledge of the contract prior to August 31, 1951 (Tr., pp. 336-337, 350, 355, 484-499, 499-511). However, their testimony was overwhelmingly rebutted by the other testimony in the case, and it was disbelieved by the trial judge.

There was, therefore, much more than mere knowledge. There was a concerted plan to falsify the facts and thereby free the timber from the contract and devote it to the purposes of the corporation.

B. The corporation is liable for damages incurred by reason of the said interference with the contract of January 8, 1948.

The tort of unlawful interference with a contract is committed where the contracting party and a third person have schemed to break the contract and destroy the plaintiff's property therein. In *Motley, Green & Co. vs. Detroit Steel & Spring Co.*, 161 Fed. 389 (C.C. N.Y. 1908) plaintiff was a local distributor for defendant Detroit Steel and had incurred great expense in preparing to execute its contract. The officers of said defendant then organized a second corporation, Railroad Steel, to which a pretended sale of Detroit's business and assets was made. Sales were thereafter made by the second corporation. The plaintiff alleged that there was, in fact, a conspiracy between the companies to destroy its contract and that as a result Detroit breached the contract and plaintiff lost commissions. The court held that the complaint set forth a single cause of action against both companies,

> "* * * for a wrongful act which they conspired to perpetrate, and which the complaint alleges they did perpetrate, acting together to a common end; their joint acts resulting in damage to the complainant. * * *" (At p. 394)

In such cases, the court said, *it is irrelevant that the third person did not seek the breach. On the contrary, both the contracting party and the third person are equally liable for the resulting damage* (at pp. 395-396).

In *Mahoney vs. Roberts*, 86 Ark. 130, 110 S. W. 225 (1908) a partnership was dissolved, and one partner agreed not to reenter the same business in the area. Thereafter the withdrawing partner organized a competing business with his wife and step-son in the name of the latter. The court said:

> "The evidence * * * was sufficient to sustain the jury in finding that the assistance given to J. Mahoney by his co-defendants was for the purpose of inducing and did induce him to violate his agreement * * * The evidence was also sufficient to sustain the jury in finding that the assistance was rendered with the intent to injure appellee (they participating in the evil intent of J. Mahoney), *or for the purpose of obtaining some benefit for themselves at the appellee's expense*, or both, to his injury. In such case they were g u i l t y of an actionable wrong, a tort, and were liable for damages." (Emphasis supplied.) (At p. 139)

In *Garst vs. Charles*, 187 Mass. 144, 72 N.E. 839 (1905) the defendant agreed with a retail druggist that the latter should order goods from the plaintiff which had a fixed resale price, that these goods should then be sold to him at the wholesale price in violation of the resale contract, and that he would then sell them at cut-rate prices. The court said:

> "A conspiracy to deprive one of the benefits of a contract with another is unlawful. * * * The defendant's arrangement with Bickford that he should break the contract was a wrong upon the plaintiff,

intended for the defendant's advantage. The scheme was fraudulent." (At p. 149)

In *Lien vs. Northwestern Engineering Co.*, 73 S.D. 84, 39 N.W.2d 483 (1949) the plaintiff had a contract with defendant partnership granting plaintiff the exclusive right to remove lime from the partners' land. The partners also agreed not to lease adjacent lands to the third persons for similar purposes. The partners thereafter executed a lease to defendant corporation, which removed a quantity of lime. Liability was imposed against defendant corporation, because there had been an intentional and wrongful interference with contractual relations and therefore with property rights (73 S.D. 84 at pp. 88-89).

See also: *Sorenson vs. Chevrolet Motor Co.*, 171 Minn. 260 at p. 265, 214 N.W. 754 (1927); *Nulty vs. Hart-Bradshaw Lumber & Grain Co.*, 116 Kans. 446, 227 Pac. 254 (1924); *Martens vs. Reilly*, 109 Wisc. 464, 84 N.W. 840 (1901); *Shannon vs. Gaar*, 233 Iowa 38, 6 N.W.2d 304 (1943); *Meyer vs. Washington Times Co.*, 76 F.2d 988 (C.A.D.C. 1935); 84 A.L.R. 43 et seq.; 26 A.L.R.2d 1227 et seq.

The tort of wrongful interference with a contract has been recognized by the Supreme Court of Oregon, and the necessary "malice" has been defined as

> "* * * nothing more than the intentional doing of an injurious act without justification or excuse."

DeMarais vs. *Stricker*, 152 Ore. 362 at p. 366, 53 P.2d 715 (1936).

See also: *Phez vs. Salem Fruit Union*, 103 Ore. 514 at p. 551, 201 Pac. 222, 205 Pac. 970 (1921).

It follows that the corporation is liable as a principal to a fraudulent scheme, since executed to the point of perjury, whereby it was sought to buy the property and disable the partners from performing their contract and to create a false appearance of good faith. As a result, logs were refused and none were thereafter offered except on terms destructive of Buffelen's rights in the contract. In short, the corporation sought to appropriate to itself the contract and property rights of appellee. There was no need for proof of any other or further "inducement" to fix liability. See *Meyer* vs *Washington Times Co.*, 76 F.2d 988 at p. 992 (C.A.D.C. 1935); *Inducing Breach of Contract*, by Francis B. Sayre, 36 Harvard Law Rev. 663 at pp. 678-680, 702; Prosser on Torts 986-987. In 4 Restatement of the Law of Torts, §766, Comment f, it is said:

> "There is no technical requirement as to the kind of conduct that may result in inducement . . . it may be the promise of a benefit to the third person if he will refrain from dealing with the other."

C. Erroneous assertions of appellant corporation.

(a) Contrary to appellant's assertion (Corp. Br., p. 5), damages in the amount of $50,000.00 (trebled by the trial court) for the value of timber removed by the corporation were not awarded because the corporation interfered with the cutting contract between Buffelen and the partners. The judgment for $150,000.00 was awarded solely by reason of the corporation's trespass against appellee's timber (Tr., p. 93). Damages sustained in the operation of the mill at Batterson in the amount of $118,000.00 were awarded against the corporation for interference with the contract, and for this the corporation is liable whether or not it trespassed against Buffelen's timber.

(b) It is said that the corporation did not seek out the partners (Corp. Br., pp. 6-7, 15), but that the partners sought the corporation as a purchaser. The record does not support the statement. It does show that Messrs. Buol and Carr (the corporation not yet having been organized) were present at many meetings at which the contract and Buffelen's rights were discussed. (See Br. Ans. Br. Gl., pp. 15-18). They participated in and carried out the decisions there made by denying all knowledge of the contract. As a result the partners ceased to tender logs, and the corporation refused to do so.

(c) The various assertions of the partners' good

faith (Corp. Br., pp. 15, 16) are wholly unsupported by citations to the record and were conclusively disproved by testimony revealing that the partners were advised that the contract was enforceable and that it could only be broken through the fiction of a sale to a bona fide purchaser (Tr., pp. 412-418, 431).

This is not a case of "noninducing interference." There was a careful and calculated scheme to destroy Buffelen's rights, and the corporation is liable as a principal party thereto.

II.

The trial court did not err in rendering judgment against the corporation for treble the value of timber removed by it from Buffelen's land (Appellant's Point II).

SUMMARY

A. The McKenneys did not become equitable owners of the timber by reason of the prepayment of stumpage.

B. The contract of January 8, 1948 was personal and non-assignable.

C. No interest in the land or timber passed to the corporation.

D. Buffelen had possession of the land.

E. The court properly awarded treble damages.

A. The McKenneys did not become equitable owners of the timber by reason of the prepayment of stumpage.

The contract gave the partners the right to enter and cut Buffelen's timber (Tr., p. 130). There was no promise to pay prior to or in the absence of cutting, nor did it provide that the partners should assume the fire risk. It contemplated a sale of personal property, i.e., logs, to the partners and an eventual sale of logged-off land; *it gave them no present interest in the land or the timber. It did not contemplate a sale of timber. Elliott* vs. *Bloyd*, 40 Ore. 326 at pp. 330-332, 67 Pac. 202 (1902); *Coquille M. & T. Co. vs. Robert Dollar Co.*, 132 Ore. 453 at pp. 469-470, 478, 285 Pac. 244 (1930); *Anderson vs. Moothart*, 198 Ore. 354, 256 P.2d 257 (1953); *Pope vs. Barnett*, 50 Ga. App. 199, 177 S.E. 358 (1934); *Northen vs. Tatum*, 164 Ala. 368 at pp. 372-373, 51 So. 17 (1909); *Brown vs. Comm'r. Int. Rev.*, 69 F.2d 863 at pp. 864-865 (C.C.A. 5 1934); 54 C.J.S. 730-731 (Logs and Logging, §29(c)). *Prepayment of stumpage therefore gave the partners no more than a contract credit on the purchase price of personal property thereafter to be appropriated to the contract. It could not work an equitable conversion.*

B. The contract to cut and tender logs is personal and non-assignable.

Cutting contracts are personal and non-assignable. *Polk vs. Carney*, 21 S.D. 295, 112 N.W. 147 (1907); *Putnam vs. White*, 76 Me. 551 at p. 555 (1884); *Bruley vs. Garvin*, 105 Wis. 625 at p. 629, 81 N.W. 1038 (1900); *U. S. Coal & Oil Co. vs. Harrison*, 71 W. Va. 217 at p. 219, 76 S.E. 346 (1912); 54 C.J.S. 731-732 (Logs and Logging §29(e)).

This one was non-assignable by its terms (Tr., pp. 134-135). The attempted conveyance therefore could transfer no rights held under the contract. *Smith vs. Martin*, 94 Ore. 132 at pp. 137-138, 185 Pac. 236 (1919); *Gunst vs. Myers*, 58 Ore. 522, 114 Pac. 925 (1911); *Burck vs. Taylor*, 152 U.S. 634, 14 Sup. Ct. 696, 38 L. Ed. 578 (1894); *Behrens vs. Cloudy*, 50 Wash. 400, 97 Pac. 450 (1908); *Bonds-Foster Lumber Co. vs. Northern Pacific Railroad Co.*, 53 Wash. 302, 101 Pac. 877 (1909); *Federal National Bank vs. Commonwealth*, 282 Mass. 442 at p. 450, 185 N.E. 9 (1933). See also: *Corvallis & Alsea Railway vs. Portland E. & E. Co.*, 84 Ore. 524 at p. 538, 163 Pac. 1173 (1917); *Goodrich Silvertown Stores vs. Collins*, 167 Ore. 40 at p. 45, 115 P.2d 332 (1941).

C. No interest in the land or timber passed to the corporation.

The partners having no interest in the land standing in Buffelen's name and no assignable interest therein under the contract, they could convey none to the corporation. *They did not attempt to assign the contract to the corporation* (Tr., p. 298). *Thus the corporation's acts in no way constituted performance of or an appropriation to the contract. They were contrary to and destructive of the contract.*

The contract to sell and Buffelen's option to purchase logs were essential and related parts of a single transaction. The corporation had full knowledge of the contract and its acts were wilful and intentional (Tr., p. 88). It cut and removed timber after asserting that it had taken it free of Buffelen's rights (Tr., p. 382).

It follows that the corporation trespassed against timber in which Buffelen had the sole beneficial interest, and it is liable to Buffelen for the value of timber removed. The partners are derivatively liable.

Buffelen concedes that if its operations in the area had terminated, or if it had exercised its conditional right to log the land, it would have had to account for sums already received. However, it had bought the timber as the sole supply of logs for a mill installed at a

cost of $150,000.00 in reliance upon the contract and to supply its Tacoma mill (Tr., pp. 129, 135, 139). To relieve the corporation and the partners of liability for the trespass would validate the very fraud the contract was designed to prevent.

At the most, therefore, the partners could assert only a setoff against the judgment in the amount of stumpage previously paid for the timber taken by the corporation. There was, however, no claim for a set off in this regard, no issue was framed on it in the pretrial order, and there was no testimony of the amount of such payment. Judgment was therefore properly entered against the corporation for treble the value of timber cut and removed ($150,000.00) and against the partners for $50,000.00, being the entire amount of the loss.

D. Buffelen had possession of the land.

The reiterated assertion that Buffelen never had possession (Corp. Br., pp. 17-18, 19, 20) is contrary to the facts. *Buffelen had a man on the land at all times checking the loggers' operations* (Tr., pp. 186, 230, 289-290). Furthermore, the partners recognized this possession and attorned to it by entering and cutting pursuant to the license given them by the contract (Tr., p. 130). Even if only deemed constructive, Buffelen's possession would be sufficient to support an action for tres-

pass. *Boyer vs. Anduzia*, 90 Ore. 163 at p. 165, 175 Pac. 853 (1918).

E. The court properly awarded treble damages.

Recognizing the wilful and deliberate nature of the corporation's acts (Tr., pp. 88, 93), the trial court properly awarded treble damages (Tr., p. 96) pursuant to ORS 105.810:

> "*105.810 Treble damages for injury to or removal of produce, trees or shrubs.* Except as provided in ORS 477.310, whenever any person, without lawful authority, wilfully injures or severs from the land of another any produce thereof or cuts down, girdles or otherwise injures or carries off any tree, timber or shrub on the land of another person, * * * in an action by such person, * * * against the person committing such trespasses if judgment is given for the plaintiff, it shall be given for treble the amount of damages claimed, or assessed for the trespass. In any such action, upon plaintiff's proof of his ownership of the premises and the commission by the defendant of any of the acts mentioned in this section, it is prima facie evidence that the acts were committed by the defendant wilfully, intentionally and without plaintiff's consent."

See *O. & C. R. Co. vs. Jackson*, 21 Ore. 360, 28 Pac. 74 (1891).

III.

There was overwhelming evidence of damage, and the court did not err in admitting Exhibits 19a, 19b, 19c and 22 establishing the amount thereof (Appellant's Points IV, V and VI).

SUMMARY

A. Evidence relating to past performance of the mill was admissible.

B. Exhibit 22 was admissible.

Appellee's basic position regarding Exhibits 19a, 19b and 19c has already been set forth (Br. Ans. Br. McK., pp. 24-28). Appellee has also discussed appellant's contentions (Corp. Br., pp. 24-25) that the mill operated on a one-shift basis and that this was the extent of the partners' obligation (Br. Ans. Br. McK., pp. 22-23; Br. Ans. Br. Gl., pp. 32-33).

A. Appellant corporation first objects that Exhibits 19a, 19b and 19c, relating to past performance of the mill, are not the best evidence, because the mill operated after October 1, 1951. The following points should be noted:

(a) No such objection was made when Exhibits 19a, 19b and 19c were offered (Tr., pp. 200-202).

(b) The evidence was conclusive that other logs were extremely difficult or impossible to get and that operation of the mill was thereby substantially reduced (Tr., pp. 220-222, 227, 464-475).

(c) Exhibits 19a, 19b and 19c were admissible to show the mill's past performance. *Exhibit 22 showed the actual operating losses sustained, which is only one part of the calculation.* Under Oregon law, the proper way to establish what the mill should have *earned* and thereby show the total amount of damages sustained by reason of the breach is to demonstrate what it earned prior to the breach. *Williams vs. Island City Milling Co.*, 25 Ore. 573, 37 Pac. 49 (1894). (See Br. Ans. Br. McK., pp. 16-17) There is no difference in this regard between a total and a partial shut down. The information is equally essential in both cases. Appellee was entitled to have the exhibits admitted, and the trial court properly received them.

(d) The purpose of the exhibits was to establish a pattern of earnings. The exhibits are attacked, however, because during certain isolated months the net profit or loss figure does not clearly relate to the quantity of logs cut in the mill during the month (Corp. Br., p. 29). It is clear, first, that such alleged inconsistencies could affect only the weight, not the admissibility of the exhibits. Secondly, the exhibits as a whole show a con-

sistent pattern of earnings after June, 1949. Furthermore, profits derive from the disposition of lumber, not from merely cutting it. Sales may be low in one month and high in another. Appellant's point is irrelevant at best.

(e) Appellant corporation's final objection to the admission of Exhibits 19a, 19b and 19c is that they are recapitulations made from books of original entry (Corp. Br., pp. 29-31). This objection, *here made for the first time,* has been discussed elsewhere (Br. Ans. Br. McK., pp. 25-28). The substance of the objection is that such summaries are not ordinarily admissible unless the primary books are first offered. No such objection was made at the trial (Tr., pp. 201-202). No motion to strike was made after it affirmatively appeared that the books were not present (Tr., p. 204). Counsel was given full opportunity to examine the witnesses regarding the exhibits and did so (Tr., pp. 203-205). The error, if any, was waived. *Employers Mutual Casualty Co. vs. Johnson,* 201 F.2d 153 (C.A. 5 1953).

B. The admission of Exhibit 22 is objected to on the grounds (a) that no foundation was laid for its admission; (b) that Mr. Gould operated the mill during part of the period to which it relates; and (c) that sufficient logs for a one-shift operation were available after January 15, 1952 (Corp. Br., pp. 31-34). None of these objections is well taken.

The statement (Corp. Br., p. 32) that there is no testimony that the exhibit accurately reflects the mill's operation is contradicted by the record, which shows that Samuel R. Miles, plaintiff's bookkeeper, was extensively examined on this very point (Tr., pp. 481-483).

The objection that Mr. Gould ran the mill during part of the period covered by the exhibit (Corp. Br., pp. 32-33) is without merit, because no damages are claimed either for lost earnings or for net operating losses during such period (Br. Ans. Br. McK., p. 19). It should be noted that Mr. Gould did not operate the mill during December, 1951 (Tr., p. 219).

The contention that sufficient logs for a one-shift operation were secured after January 15, 1952 (Corp. Br., p. 33) has been discussed elsewhere (Br. Ans. Br. McK., pp. 22-23; Br. Ans. Br. Gl., pp. 32-33; supra, p. 26), The mill opened only in April, 1952 (Tr., pp. 480, 483), and Mr. Gansberg's testimony to the contrary resulted from a misunderstanding of counsel's question (Tr., pp. 470, 474).

Counsel again attempts to show that the figures contained in the exhibit are inaccurate (Corp. Br., pp. 33-34). Sales differences are again ignored, and the particular item relied upon, fixed expenses of $20,837.76 in March, 1952, was fully explained by Mr. Miles (Tr., p. 482).

No error was committed in admitting these exhibits. Exhibits 19a, 19b and 19c disclosed the past earning record of the mill. Exhibit 22 showed the exact extent of the net losses sustained. Appellee was entitled to recover not only lost earnings, but also net losses suffered during the period. See *Wells vs. National Life Ass'n.*, 99 Fed. 222 at pp. 228-229 (C.C.A. 5 1900); Br. Ans. Br. McK., p. 19.

IV.

Appellant could not receive any interest in the timber free from Buffelen's rights therein.

SUMMARY

A. Appellant received the conveyance with knowledge of Buffelen's rights.

B. Any interest received by appellant was subject to Buffelen's right to purchase all logs cut from the land.

Appellant corporation has insisted throughout (which appellee denies) that it took equitable title to the timber by reason of the "conveyance" of August 31, 1951 (Tr., pp. 7, 17; Corp. Br., p. 18). It does not deny that it then knew of the contract and the terms thereof (Corp. Br., pp. 4-15). Buffelen had repeatedly demanded delivery of all saw and peeler logs (Tr., pp. 180-181,

183, 195-196, 206, 213, 229, 250, 251, 259-260, 309-310, 313, 339, 376).

> The court enjoined appellant corporation from "trespassing on the land or injuring or cutting timber covered by the contract * * *" (Tr., p. 95).

Even if (which appellee denies) the corporation received any interest whatever in the land or timber owned by Buffelen and standing in Buffelen's name, that interest was taken subject to Buffelen's rights, and the decree, insofar as it sustains those rights and forbids the cutting or removal of timber, must be affirmed. Furthermore, the decree must be affirmed insofar as it prevents the corporation from cutting or removing timber from the land owned or controlled by the partners and included in the contract.

In *Southwest Pipe Line Co. vs. Empire Natural Gas Co.*, 33 F.2d 248 (C.C.A. 8 1929), a contract whereby A was to purchase gas produced from certain wells owned by B was effectively enforced against B's transferee, because the transferee had received the wells with notice of A's rights. Although such transferee could not be held liable for damages for breach of the contract between A and B (see *Mound Valley Vitrafied Brick Co. vs. Mound Valley Natural Gas & Oil Co.*, 258 Fed. 936 (C.C. Kan. 1911)), the transferee took the property subject to plaintiff's rights and could be re-

strained from interfering with or injuring them. See also *Guffey vs. Smith*, 237 U.S. 101, 35 Sup. Ct. 526, 59 L. Ed. 856 (1915); *Nordin vs. May*, 188 F.2d 411 at p. 415 (C.A. 8 1951); *Kelley vs. Central Hanover Bank & Trust Co.*, 11 Fed. Supp. 497 at pp. 509-510 (D.C. N.Y. 1935); *Meyer vs. Washington Times Co.*, 76 F.2d 988 (C.A. D.C. 1935).

The fact that this was a contract for logs rather than gas is immaterial. In the *Southwest Pipe Line* case, supra, it was argued that the decree in effect granted specific performance of a contract for the sale of personal property. Nonetheless, the court held that appellant's remedy at law for breach of contract was inadequate.

> "The action of appellant was a trespass upon appellee's rights, assuming that those rights were known to it. Equity could enjoin such interference, and, if the same worked specific performance of a contract to which appellant was not a party, that would be relief incidental to the protection of the rights granted by the contract." (33 F.2d 248 at p. 258).

The contract itself establishes the unique importance of this timber to Buffelen and its Batterson and Tacoma mills (Tr., pp. 127, 130, 135). The contract was therefore one susceptible to equitable protection. *Livesly vs. Johnston*, 45 Ore. 30 at pp. 49-50, 76 Pac. 13, 946 (1904); 152 A.L.R. 4 at pp. 14 et seq., 20 et seq. See also: *Rector*

of St. Davids vs. Wood, 24 Ore. 396, 34 Pac. 18 (1893); *Clark vs. Flint*, 39 Mass. (22 Pick.) 231 (1839).

Appellant corporation cannot avoid this result by contending that appellee was under no duty to purchase logs.

(1) Any such objection is directed solely to an asserted lack of mutuality which, it is claimed, prohibits equitable relief. It therefore relates only to the equitable nature of the relief granted and has long been waived (see Gl. Br., pp. 68-74; see discussion in Br. Ans. Br. Gl., pp. 45-46).

(2) Any right to specific performance or equitable relief dependent upon an election to take logs was perfected by Buffelen's repeated and insistent demands that all saw and peeler logs be delivered (see supra, pp. 2-10, 30-31).

The parties had treated a general demand as a proper election under the option between May 22, 1951 and September 1, 1951, during which period all saw logs were bought under a similar general instruction (see supra, p. 7). Such instruction was therefore effective without regard to any right of inspection or rejection by Buffelen. *Armstrong vs. Maryland Coal Co.*, 67 W. Va. 589, 69 S.E. 195 (1910). This practical construction of the contract is binding upon the parties (see Br. Ans. Br. Gl., pp. 42-43).

Furthermore, the option itself is binding on the purchaser with notice. An election under it is valid as against an intervening purchaser (50 A.L.R. 1314). The option had been fully exercised.

(3) Oregon law requires only mutuality of remedy for specific enforcement of contracts. *Percy vs. Miller*, 197 Ore. 230, 251 P.2d 463 (1952). Apart from the option, this contract was mutual. The loggers had many valuable and presently enforceable rights under the contract. They had the right, in the event the mill should be shut down, to take it over and operate it themselves in order to process and dispose of their logs (Tr., pp. 138-139). They were entitled to log the entire area of Buffelen's holdings and receive the loggrs' profit therefrom (Tr., p. 130). They were entitled to a conveyance of logged-off land for a nominal consideration (Tr., p. 132). In no sense of the word can it be said that the contract was not sufficiently mutual to entitle the parties to equitable protection.

(4) As it relates to the corporation, this was not a suit for specific performance, and the question of the option or the exercise thereof is irrelevant. See *Southwest Pipe Line Co. vs. Empire Natural Gas Co.*, supra, 33 F.2d 248 at p. 258 (C.C.A. 8 1929). In *Guffey vs.*

Smith, supra, 237 U.S. 101, 35 Sup. Ct. 526, 59 L. Ed. 856 (1915), an oil lessee was granted an injunction against the operations of one holding a similar but subsequent lease from the same lessor. *The lease was terminable at any time*, and it was contended that the contract was not sufficiently mutual to support a suit for specific performance. The Supreme Court said:

> "Rightly understood, this is not a suit for specific performance. Its purpose is not to enforce an executory contract to give a lease, or even to enforce an executory promise in a lease already given, but to protect a present vested leasehold, amounting to a freehold interest, from continuing and irreparable injury calculated to accomplish its practical destruction. * * * In a practical sense the suit is one to prevent waste, and it comes with ill grace for the defendants to say that they ought not to be restrained because, perchance, the complainants may sometime exercise their option to surrender the lease * * *" (237 U.S. 101 at p. 115).

See also: *Crown Orchard Co. vs. Dennis*, 229 Fed. 652 at pp. 654-655 (C.C.A. 4 1915).

(5) Finally, the propriety of injunctive relief against one interfering with a contract to sell personal property produced from land has been specifically rec-

ognized by the Oregon Supreme Court. See *Phez Co. vs Salem Fruit Union,* 103 Ore. 514 at pp. 551-552, 201 Pac. 222, 205 Pac. 970 (1921), noted in Pomeroy on Equity Jurisprudence (5th Ed., 1941) 945 (§13.44). See also *Meyer vs. Washington Times Co.,* 76 F.2d 988 (C.A.D.C. 1935).

Therefore, any interest in the land or timber embraced in the contract and received by the corporation under the attempted conveyance of August 31, 1951 was taken subject to Buffelen's rights to have the first refusal of all logs cut from it. The decree protecting those rights must be sustained.

CONCLUSION

The record in this case, as it affects appellant corporation, is clear. The corporation was organized as a device for diverting Buffelen's timber and contract rights to the private advantage of third persons, who thereby sought to "cut themselves in" on Buffelen's holdings. This involved not only a fraudulent scheme to establish the corporation as a bona fide purchaser; it perpetuated itself in the form of false testimony at the trial and retrial of the case. The legal questions raised by appellant corporation are without merit, and in view of the record

there is no doubt of its legal or moral liability for the sums awarded against it.

The Judgment and Decree of the trial court must be affirmed.

Respectfully submitted,

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No. 14188

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

REPLY BRIEF OF APPELLANT McKENNEY LOGGING CORPORATION

Appeals from the United States District Court for the District of Oregon.

S. J. BISCHOFF,
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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 9-54

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TABLE OF CASES AND STATUTES

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PRELIMINARY STATEMENT

Appellee argues every phase of this case on the hypothesis that it was the actual or beneficial owner of

the property with all incidents of ownership, including possession. No attempt is made to predicate any rights on the basis that it was a mortgagee *out of possession* whose debt has been paid in full and whose only surviving right under the contract, if any there be, was an option to purchase "logs" (personal property) at market price.

I.

Re: Appellee's Point I. Alleged Interference With And Inducement to Breach Contract By McKenney Logging Corporation.

Appellee does not seriously question the legal principles enunciated and applied in the authorities cited by Appellants that mere knowledge of the contract does not constitute inducement to breach the contract. Appellee contends (Br. 13):

> "appellant corporation, not only knew of the existence of the Buffelen contract, but *schemed with Mr. Errion and the partners* to commit a fraud on Buffelen *by agreeing to misstate the facts* in an effort to destroy Buffelen's rights in the timber. . . ."

There is *no finding of fact* that the Corporation, or Buol or Carr, "schemed" to defraud Buffelen, or that they "conspired" to do so, or "coerced", or "induced" McKenney and Glaser to breach the contract. The only finding of fact is that the

> "Corporation had knowledge of the contract". (Finding XI, Tr. 88).

The testimony of Matott and McKenney does not establish such an agreement or any coercion or induce-

ment on the part of the Corporation. It merely demonstrates that Errion and Matott (Agents of McKenney and Glaser) in their eagerness to consummate a sale and earn commissions, attempted to demonstrate that the Buffelen contract was not an obstacle to the transaction because it had been breached in a number of respects by Bueffelen and that in any event, the indebtedness had been paid in full.

To that end, *Errion and Matott* made a critical examination of the contract, listed the respects in which it had been breached, and they arranged a meeting at Mr. Prendergast's office (attorney for McKenney and Glaser, not for the Corporation or Buol and Carr), *to have him confirm their conclusions.* It was at this meeting that the agreement to "mistate facts" was supposedly made. (Matott, Tr. 415). (McKenney, Tr. 439).

The meeting was suggested by Errion (Tr. 410). This activity was not originated, suggested, or carried on by Carr or Buol. They did not urge or seek ways of abrogating the Buffelen contract or urge or induce McKenney and Glaser to do so.

This activity cannot, by any stretch of the imagination, be tortured into inducement by Carr and Buol to coerce McKenney and Glaser to sell them the property. No one testified that Buol was present at either meeting and he was not even mentioned as a prospective purchaser (Tr. 431). It is only claimed that Carr was present. He denies being present. Prendergast was not his attorney at that time. The first time he was in Prendergast's office was in October after this action was commenced (Tr. 486).

Referring to the interview at Mr. Prendergast's office, Matott testified (Tr. 396):

> "Well, there seemed to be two questions there. One was whether or not the contract had been broken, and the other was how the sale was to be handled in order to get around the contract. *And it was decided there that the buyer was to be ignorant of the contract.*
>
> Q. What advice or opinion, if any, did Mr. Prendergast give at that conference with respect to the Buffelen contract?
>
> A. He advised that the buyer should be held in that position of an innocent purchaser."

Matott did not include McKenney as among those present (Tr. 396), and McKenney had no recollection of Matott being at that meeting (Tr. 439-441). Yet both testified Carr was present. At the time it was not even known that Carr would be a party to the transaction (Tr. 405, 409, 434).

Buol was not even mentioned at the meeting (Tr. 416, 417-431) and obviously could not have agreed to anything.

The phrase, used by Matott,

> "And it was decided there that the buyer was to be ignorant of the contract", (Tr. 396)

was obviously the conclusion of the witness. He did not testify to what was said by anyone present from which the conclusion can be drawn. McKenney, who claims he was present, did not testify that such an agreement was made. *Neither of them testified that Carr did or said anything that can be construed as an assent to such an agreement,* and Carr denies he was present.

The answer is equivocal. It is susceptible of two constructions. *One* is that Mr. Prendergast, a reputable attorney, had given dishonest advice that Carr (who was not his client) should assume and maintain the position of an innocent purchaser; and the *second* is, that he advised objectively that only an innocent purchaser would not be bound by the contract. Between these two equivocal interpretations of the conclusory answer, the latter must be adopted for it cannot be assumed that Mr. Prendergast deliberately advised the commission of a fraud by Carr, especially when he was not at the time his client and was not at the time a prospective purchaser.

Neither Matott nor McKenney attributed to Carr any statement or act on his part which would constitute acquiescence, coercion or interference.

Matott's own testimony demonstrates that it was not "decided" that the buyer was to be ignorent of the contract for he later testified, and McKenney likewise, that

> "McKenney insisted that the buyer, Mr. Buol, be fully aware of the Buffelen contract." (Tr. 427).

Exhibit 21, Memorandum of August 14th meeting, made by Matott and McKenney, does not purport to be a memorandum of an agreement on the part of Buol. (Carr is not mentioned.) It is merely a memorandum of instructions from McKenney to his Agents, Errion and Matott, as to the terms to be submitted to Buol (not Carr) for acceptance. It begins as follows:

> "You are hereby instructed and authorized to proceed as per our oral agreement . . ."

There is no evidence of any affirmative act on the part of Buol or Carr of any agreement by them or of inducement, coercion, or participation in any conspiracy or scheme to interfere with or breach the Buffelen contract.

The testimony of Matott and McKenney is merely to the effect that Carr or Buol were aware of the contract and no more and this, under the principles set forth in Section 766 of the Restatement of the Law of Torts, is not inducement or coercion of McKenney and Glaser to breach the contract.

Re: Cases Cited by Appellee.

The cases cited by Appellee do not support the proposition that mere knowledge of the existence of a contract between A and B would constitute interference with and inducement to breach the contract. In the cases cited, the third party was merely the alter-ego of the party to the contract, created by him for the very purpose of enabling him to breach the contract.

The case of *Motely, Green & Co. v. Detroit Steel & Spring Co.,* 161 Fed. 389, cited by Appellee, is that sort of a case. The District Judge rendered a decision on a demurrer to the complaint, which assumed the allegations to be true. The complaint alleged that the plaintiff entered into a contract with the Detroit Company by which it was made its sole sales agent. In order to destroy that contract, Detroit Steel organized a corporation (Railway Steel) having substantially the same officers to be "the Sales Agent for Detroit". The Court

held the two corporations were "in fact, one" and that this was a

> "device and conspiracy between the two companies to break the contract . . ."

The Railway Corporation was the alter-ego of the Detroit Corporation. Upon these facts, both corporations were held liable.

There is no such relationship between the Logging Company and the Corporation. Here, we have an arms-length outright purchase and sale of property.

The case of *Mahoney v. Roberts,* cited by Appellee (p. 16), a retiring partner contracted not to re-enter the same business in the area. For the express purpose of avoiding this covenant, the retiring partner formed a sham partnership with his wife and a minor stepson to do business in the name of the stepson and he carried on the business in the area in violation of that covenant. They were all held liable because they actively participated in this fraudulent scheme which was devised for the express purpose of enabling the retiring partner to violate his contract.

These cases are typical of all of the cases cited by Appellee in this connection.

No case is cited which takes issues with the rule crystalized in Section 766 of the Restatement of Law of Torts (cited, p. 8, Opening Brief).

The *Phez* case, 103 Or. 514, did not involve the liability in *tort* of a third party for interfering with or inducing a breach of contract. The two parties defendant

were the "Growers", the principal, and the "Fruit Union", their Agents. Liability was imposed on the Growers as principals for *breach of contract* and not for the tort of inducing a breach by someone else.

The *DeMarais* case, 152 Or. 362, is a typical case of actual "coercion". The defendants, members of a State Board, forced an employer to discharge the plaintiff-employee by unlawfully refusing to issue a license required by law to the employer unless he discharged the plaintiff. The Court, in imposing liability, pointed out the distinction between "mere persuasion" and "coercion". The coercion must be

> "such as to preclude the employer's exercise of his free volition. It is not sufficient to offer him a choice; he must be *so constrained that he does not feel free to exercise an independent judgment.*"

This is the kind of interference, inducement, or coercion which is contemplated in the law of torts, imposing a liability for inducing a breach of a contract.

II.

Re: Appellee's Point II

Under Point II, Appellant Corporation contends that Appellee is not entitled to recover damages for trespass because it was not the beneficial owner or in possession of the timber lands and the timber removed therefrom, was not its property. This was predicated upon the ground that Appellee was merely a mortgagee out of possession; that its debt had been paid; that it merely

held the naked legal title in trust for the beneficial owner, to-wit, the Logging Company or its transferee, the McKenney Logging Corporation who were in possession, and that the only surviving right that Appellee had at the time of the alleged trespass, was the bare "option" to purchase "logs" at market price, which it might never exercise.

The partners, and later the Corporation, were not mere licensees as contended by Appellee. They were in possession as owners, cutting their own timber. After the debt was paid, they were the exclusive owners with all the beneficial interest and rights inherent in ownership and possession. The fact that the naked legal title was still in Appellee, coud not, and did not, change these legal consequences.

Appellee argues (Br. p. 21) that there was no promise to pay prior to or in the absence of cutting, that the contract did not provide that the partners should assume the fire risk and that it contemplated a sale of personal property, "i.e., logs." This is a distortion of the contract. The contract does not require the Logging Company to pay for any "stumpage" or for "logs". *All of the provisions in the contract for payments to be made by the Loggers were to be in re-payment of the loans or "advances" made by Appellee to the Loggers and not as the purchase price of "stumpage" or "logs".*

The rates per thousand board feet at which payments were to be made, merely measured the amount of the installment payments in satisfaction of the loans and not payment as the purchase price of either stumpage, logs, or real property.

Contrary to the assertion of Appellee, the contract specifically creates an obligation on the part of the Logging Company to pay the loans in full *regardless of the amounts realized from the logging operations.* It provides (p. 131):

> "In the event however, when the timber of the Lumber Company is all logged, the Logger shall pay to the Lumber Company (Appellee) any additional amount required to reimburse it for the total cost of its holdings as herein defined and in the event the Logger has paid more than the actual cost, then the Lumber Company shall refund such overpayments to the Loggers."

The assertion that the Logging Company was not to assume the fire risk is also contradicted by the contract and by the evidence. The contract provides (p. 130) for the repayment of all the advances with interest

> "and any and all taxes and carrying charges *and expenses* incurred by the Lumber Company in connection with the purchase of such timber."

Fire protection of the timber is, of course, an expense incident to the transaction and the evidence establishes that the Logging Company paid for the fire protection. McKenney testified (Tr. 285), that the Logging Company paid for the fire protection and the taxes and he produced the cancelled checks and receipts therefore. There is no testimony to the contrary.

Appellee's statement (p. 21)

> "It contemplated a sale of personal property, i.e., logs, to the partners"

is indefensible. There is not a word or syllable in the contract which can be construed as an agreement on the

part of Appellee to sell, and the Logging Company to purchase "logs". The contract is the very opposite. *The Logging Company was to sell logs to Appellee when it exercised the option to purchase logs.*

It is argued by Appellee (p. 21) that cutting contracts are personal and non-assignable; that this contract was non-assignable by its terms and, therefore, the Corporation acquired no rights under the contract.

In the first place, it is immaterial whether the Corporation acquired any rights under the contract for the *purpose of determining whether Appellee can maintain trespass.* It could only maintain trespass on the strength of its own possession and ownership for trespass is an invasion of the right of possession. It cannot succeed on the weakness of the defendants' right of possession or title. If the transfer was inoperative for any reason, the ownership and right of possession remained in the Corporation's transferor, the Logging Company. It did not vest ownership or possession in the Plaintiff to support an action in trespass.

The clause prohibiting transfer of the property without consent became inoperative when the indebtedness was paid off. Appellee ceased to be a mortgagee at that time. It no longer had any interest in the real property as such. The Logging Company was at liberty to sell and convey its beneficial interest as owner of the real properties. The Corporation acquired such beneficial ownership and with it, the actual possession.

Since Appellee only had, at that time, an option to purchase logs, there was nothing to prevent a convey-

ance of the properties to the Corporation. The most that Appellee could rightfully contend for under these conditions, is that the Corporation acquired the ownership of the lands subject to that option and if the option survived the payment of the loans, Appellee might have a cause of action for damages for breach of the option agreement. *But it had no cause of action in tort for trespass* for it had neither ownership nor possession.

Re: Possession.

Appellee now claims that it was in possession (Br. 24).

There is no finding of fact that Appellee was in possession of the timber lands at the time of the alleged trespass or at any time.

In the absence of a finding of fact that Plaintiff was in possession, a judgment in an action for trespass cannot be sustained for possession is the very gist of the action.

Appellee's claim of possession is based on testimony that the Buffelen Company had an employee present where the logging operations were carried on. But he was there merely for the purpose of selecting logs to be purchased (Tr. 289-290 and 230). This employee was not there to take and hold possession of real property or to exercise any dominion or control over it.

Constructive possession may be sufficient to enable a plaintiff to maintain trespass when dealing with *vacant and unoccupied lands as against a stranger who neither*

has or claims any interest in the land or possession thereof, but never as against the beneficial owner who is in possession.

The case of *Boyer v. Anduiza,* 90 Or. 163, cited by Appellee, contains no intimation that a plaintiff can maintain trespass on constructive possession *as against true owner in actual possession.* Defendant was a total stranger who "claimed no interest in the land or the grass thereon."

In 63 C.J., 905, Section 22, Title "Trespass", the text says:

> "Constructive possession is that possession which the law presumes the owner has, *in the absence of evidence of exclusive possession in another. If defendant is in actual possession, constructive possession in plaintiff is excluded."* (Emphasis supplied.)

In *David v. State,* 89 Atl. 214, the Court held:

> "Trespass is an injury to the possession of property, and therefore one who complains of such an injury *must show himself to have been in possession at the time the trespass was committed."* (Emphasis supplied.)

In *Pueblo & A. V. R. Co. v. Beshoas,* 5 Pac. 639 (Col.), plaintiff, in a trespass action, held legal title as security. The grantor (equitable mortgagor) was in possession. There had been no foreclosure and sale. The Colorado Statute (Section 263, Dawson's Code) provided:

> " 'A mortgage of real property shall not be deemed a conveyance, whatever its terms, so as to enable the owner of the mortgage to recover possession of the real property, without foreclosure and sale . . .'

The Court held that that statute deprived

> "A mortgagee of all right of possession, either before or after condition broken"

and that

> "Before a right of possession springs into existence, the mortgagee must foreclose his mortgage and sell the realty mortgaged. Having no title to the premises, and *not being in any way authorized to possess or occupy* the same, *plaintiff could not recover for damages thereto.* The judgment will be reversed, and the cause remanded."

The Oregon Statute (Sec. 86.010 ORS) is substantially the same as Colorado and the construction thereon is the same.

Jones on Mortgages, 8th Ed., Sec. 849, p. 166, says:

> "But in States where a mortgage is a lien only, a mortgagee not in possession and not entitled to possession, *cannot maintain an action of damages for trespass.*"

In *Investors Syndicate v. Smith,* 105 F. 2d 611, this Court construed the *Oregon Statutes.* After an exhaustive review of authorities, this Court held that a mortgagee has only a lien and is not entitled to possession until foreclosure and sale.

In Oregon, the same principle is applicable to cases where a deed is given to secure an indebtedness. *Caro v. Wollenberg,* 68 Or. 420.

In this connection, the distinction should be kept in mind between "stumpage" and "logs". Appellee uses these terms indiscriminately.

"Stumpage" is "*standing timber* in the *tree*" on the land, and is real property.

Ciapusci v. Clark, 106 Pac. 436;
Ray v. Schmidt, 66 S.E. 1035;
Nitz v. Bolton, 39 N.W. 15;
Gordon v. Grand Rapids, 61 N.W. 549.

"Logs" are personal property. They come into being only after the timber is severed and cut up into required lengths ready for removal.

III.

Re: Appellee's Point III.

Appellants' contention is that it is not liable for the $118,000.00 alleged loss of profits because it was under no contractual obligation to supply the Batterson Mill with logs, is supported by the case of *Mound Valley V. B. & Co. v. Mound Valley N. G. & D. Co.,* 258 Fed. 936, cited by Appellee (p. 31). The Court held in that case that the assignee of the contract was not liable for failure to sell Plaintiff gas under the terms of the contract in the absence of a novation or assumption of the contract by the assignee.

In the case at bar, Buffelen cannot repudiate the Corporation as transferee or assignee and at the same time, hold it liable for an alleged breach of the contract.

In any event, this is not an action for breach of contract and the Corporation cannot be held liable in tort if it did not induce or coerce a breach of the contract.

Appellee presents, under its Point III, its response to Appellant's Points IV, V, and VI, all of which relate to the allowance of the $118,000.00 damages for the alleged failure to supply logs for the operation of the Batterson Mill.

Appellee's Brief fails to demonstrate how this figure can be justified by the record.

This is not a case where a plant is shut down entirely during the period in question and estimates based on past experience, must be resorted to to establish loss of profits as in the *Bredemeier* case, 64 Or. 576, cited by Appellee.

The mill was in operation intermittently during the ten month period (January to October) for which loss of profits is claimed. Part of the time, the mill was shut down on account of "strikes", "fire weather" and "mill break downs." (Tr. 470-471). According to Appellee's own testimony, the mill had sufficient logs to operate on a one shift (contractual) basis (Tr. 469-470).

The month of December 1951 cannot be included contrary to Appellee's contention because the mill was operated by Gould during that month. Exhibit 22 (Tr. 480) shows that during October, November and December, the operation was by Gould. There is a bracket around these three months followed by the notation

"Operated by Gould. His figures not included."

Loss of profits are claimed for the period of time *subsequent to the commencement of this action,* which

is brought to repudiate the contract and the Corporation as a party thereto, and

"to declare a forfeiture of the contract". (Tr. 242).

The Corporation was not under obligation to supply logs to Gould while he was operating the mill and no claim is made for loss of profits during that period.

Exhibit 5 (Tr. 242), a letter from Buffelen to the Corporation, shows that the Corporation tendered Buffelen, prior to November 3rd, logs invoiced at $49,031.62 and $19,497.81, a total of $68,529.43; that Buffelen tendered payment for these logs but attached a condition. It is obvious, therefore, that the mill did not shut down for inability to obtain logs, but because Buffelen wanted the logs and at the same time to effect a "forfeiture of the contract." Buffelen could not refuse to take the logs tendered and then claim damages for loss of profits for failure to supply logs.

Since the mill was in operation and had enough logs to operate on a one shift basis, the loss of profits during that period must be attributed to causes other than lack of logs.

In any event, loss of profits cannot be determined by past experience in this case. The cause must be determined by the actual experience during the period in question. There is no occasion in this case for indulging in estimates.

The experience shown by Exhibit 21 demonstrates that there is no certainty of profits from the operation of the mill on a one shift basis.

Omitting the four months during which the mill was not in operation for various reasons, the Exhibit shows the following:

	Profit	*Loss*	
April		$7,890.96	1 Shift
June	$1,642.76		1 Shift
July		570.05	1 Shift
August	7,414.86		1 Shift
September	9,189.22		1 Shift
October		2,412.24	1 Shift

This exhibit demonstrates that profits do not inevitably result from a one shift operation. The monthly experience fluctuates from a high loss of $7,890.96 to a high profit of $9,189.22.

Exhibit 19 a-b-c (assuming it was admissible) does not support the estimate that the mill earned profits of $9,000.00 and $6,000.00 per month in the preceding two years for the following reasons:

(a) The summaries are based upon operation of the mill on two and three shift basis; whereas, the contract obligated the Logging Company to supply logs sufficient to keep the mill running on a one shift basis (Tr. 133-134-135).

(b) The profits shown in Exhibits 19 a-b-c, are *not actual profits.* They are *paper or bookkeeping profits.* 78% were interdepartmental transfers of the lumber by Buffelen Company to its various departments. These were not arms-length sales on the open market.

For example, Exhibit 19-b, which shows the operations for twelve months ending June 30, 1950, shows

the disposition of 18,105,662 feet of lumber in that year as follows:

Disposition of Lumber	Number of Feet	Alleged Sale Price	Average per M ft.
Transferred to:			
Hardwood-Tacoma	9,402	$ 1,504.32	$160.00
Door Factory-Tacoma	8,354,781	661,973.55	79.23
Sawmill-Tacoma	5,824,361	168,652.78	28.96
P. M. No. 3	66,738	6,673.80	100.00
Sold to *Others*	3,850,380	125,337.27	32.55
Sales Allowances		(1,312.45)	
	18,105,662		

21 plus % were alleged sales "to others". The sales "to others" were, in reality, the trading of lumber Buffelen could not use for "peelers" and "shop lumber" for use in its plywood and door plants.

The departmental transfers were at bookkeeping prices, averaging $79.23 per thousand board feet, while the sales (trades) "to others" were at $32.55 per thousand. These were not arms-length transactions.

Exhibit 19 a-b-c do not sustain a finding of estimated profits of $9,000.00 and $6,000.00 per month in the preceding years.

(c) Profits from the sale of lumber could not, under the facts in this case, constitute the measure of damages because such profits were *not within the contemplation of the parties*. The evidence of plaintiff's own officers and agents, establishes:

(1) That the Buffelen Company was not engaged in the purchase and re-sale of *logs* in the ordinary course of business for profit;

(2) It was not engaged in the business of manufacturing and selling *lumber* as such for profit;

(3) It was engaged in the *plywood business* and *door manufacturing business*. The object of the contract and the establishment of the Batterson Mill, was *to furnish a source of supply of lumber for use in its plywood and door manufacturing plants* and *not for the sale of lumber*. Its primary concern was to obtain "peelers" and "shop lumber", meaning a specific type of lumber cut to certain specifications suitable especially for door manufacturing purposes. *The lumber cut at the Batterson Mill was not manufactured to be, and was not, sold in the open market for the realization of profits from the sale* (Tr. 187 to 192 and 253 to 256).

If Plaintiff ever became entitled to recover for loss of profits, it would be loss of profits *in the operation* of its *plywood* and *door factories* and not profits from the sale of lumber in the open market.

It is not claimed in this case that profits were lost in the operation of the *plywood* and *door manufacturing plants* or that there were any sales lost by reason thereof.

It is settled law in Oregon, as it is everywhere beyond any question, that loss of profits is not a proper measure of damage in any event unless such loss was *in contemplation in connection with the subject matter of the sale*.

In the *Bredemeier* case, 64 Or. 576, cited by Appellee, the Court held:

> "The general rule is that, in order to recover profits in case of a breach of contract, such profits *must have been within the contemplation of the parties*

> at the time of the execution of the contract; and, where such profits do not enter into the contract itself, they will be denied. Anticipated damages, different from those which would ordinarily be sustained, are not always recoverable, but will only be awarded when, in view of special circumstances, they may be regarded as the natural and direct result of the breach, and are not problematical, but are capable of being foreseen and of being estimated with reasonable accuracy.
> "Where the damages claimed are so speculative and dependent upon numerous and changing contingencies that their amount is not suspectible of actual proof with any reasonable degree of certainty, no recovery can be had."

In *Martin v. Neer,* 126 Or. 345, a case relied on by Appellee, the Court said:

> "But, before a contemplated profit can be recovered the evidence must establish that it was reasonably certain to accrue. Uncertainty as to the amount is not fatal, *but an uncertainty as to whether any benefit or gain would be derived bars a claim for damages founded on alleged profits.*"

(d) In the case at bar, the evidence fails to support a finding that profits

> "was reasonably certain to accrue".

This is demonstrated by Exhibits 19 a-b-c, and Exhibit 22. For example, in the month of June 1951, the mill operated on a two shift basis. It cut 1,708,278 feet of logs and sustained a loss of $13,997.60 (Exhibit 19-C, first page), while in the preceding month of May 1951, it cut substantially the same amount of logs and made a book profit of $4,298.41. Now, the experience in these two months demonstrates clearly that there was no rea-

sonable certainty that profits would accrue from the operation of the mill, whether on a two shift or one shift basis. The same discrepancy is apparent in Exhibit 22, which covers the period for which the loss of profits is sought. During this period, the mill was operated on a one shift basis, yet we find, for example, that in April 1952, it sustained a loss of $7,890.96, while in June, it made a profit of $1,642.76. The uncertainty is manifested when the figures are read across the page. The amount of logs cut in the two months were substantially the same ($29,204 in April and $24,231 in June), yet, the "manufacturing expense" (separate from payroll and other expenses) was $8,994.00 in April and $2,694.00 in June. While they cut about $5,000 more logs in April, they sustained a loss of $7,890.96, and while they cut only $24,000 logs in June, they made a profit of $1,-642.00. How can it be said that there is any certainty of profit from the operation of the mill?

These illustrations can be multiplied many times by an examination of these exhibits.

In *Randles v. Nickum & Kelly Sand & Gravel Co.*, 169 Or. 284, the Court adopts the rule set forth in 15 Am. Jur., Damages, 574, Sec. 157, as follows:

> " 'The proof must pass the realm of conjecture, speculation or opinion not founded on facts, and must consist of actual facts from which a reasonably accurate conclusion regarding the cause and the amount of the loss can be logically and rationally drawn' ".

In the very recent case of *Fireside Marshmallow Co. v. Frank Quinlan Const. Co.*, 213 F. 2d 16 (8th), the

plant was shut down completely for a period of time by reason of defendants breach of contract. The Court rejected Plaintiff's estimate of loss of profit of $1,000.00 per day because it was

"not based on any probative facts in the record"

and held that evidence that is "conjectural" and "speculative" could not form "a legal basis for determining" loss of profits.

The Court said:

"To warrant such a recovery (loss of profits) in other words, the proof must pass the realm of conjecture, speculation or opinion not founded on facts, and must consist of actual facts from which a reasonably accurate conclusion regarding the cause and the amount of loss can be logically and rationally drawn."

loss of profits. The Court said:

"It is generally held that the expected profits of a commercial business are too remote, speculative and uncertain to permit a recovery of damages for their loss. To warrant such a recovery in other words, the proof must pass the realm of conjecture, speculation or opinion not founded on facts, and must consist of actual facts from which a reasonably accurate conclusion regarding the cause and the amount of loss can be logically and rationally drawn."

. . . . .

"It is not to be inferred that recovery for loss of profits may not in a proper case be had. But to warrant such a recovery profits must be capable of being measured or ascertained on a reasonable basis. 'The sufficiency of the evidence of profits as an element of recoverable damages is dependent upon whether the data of which the evidence consist is

such that a just and reasonable estimate can be drawn from it, * * *.' Twentieth Century-Fox Film Corp. v. Brookside Theatre Corp., 8 Cir., 194 F. 2d 846, 855."

IV.

Re: Appellee's Point IV.

Appellee attempts to sustain the decree insofar as it grants injunctive relief on the basis that the Corporation did acquire the equitable title to the timber lands, but did so subject to Buffelen's rights and that such rights can be protected by injunction.

The conclusion does not follow the premise because *the only surviving right,* if any, *was the option to buy logs,* (personalty) and as argued in the brief of Glasers (pp. 68 to 74), there is no equitable jurisdiction to grant any equitable remedies (specific performance or injunction) because

(a) an option is not an enforceable contract prior to the election to exercise it and lacks mutuality;

(b) an option to buy logs (personal property) creates no interest in real property;

(c) there is nothing unique about an option to buy logs which will invoke equitable jurisdiction.

Appellee now urges it did exercise the option; that it thereby converted the option into a binding contract to purchase and supplied the essential element of mutuality.

There is *no finding of fact* that it exercised the option and converted it into an absolute contract to purchase all the logs until the timber was exhausted.

Even if this were true, it would still be only a contract for the purchase of personal property not enforceable in equity.

It is not true that the option was exercised at the time the action was commenced or even thereafter. Buffelen did, from time to time, elect to buy some of the logs produced by the Logging Company (about 50%). It did not buy any peelers at all for the Tacoma Plant. But Buffelen never did elect to take "all" of the logs (saw logs and peelers) that would be produced by the Loggers in the future from the timber lands described in the contract until all of the timber was exhausted. This option could only be converted into a binding contract to buy "all" of the logs cut from the timber lands here involved until all of the timber was exhausted, and this it could only do by an unequivocal election to do so, so that at any time thereafter, upon Buffelen's refusal to accept any logs of any kind and of any grade, the Logging Company would have a cause of action for breach of contract. Buffelen never did make such an election at any time. It carefully avoided placing itself in that position. In the May 1951 conversation, Holm merely

> "advised either Mr. McKenney or Mr. Glaser that Buffelen wished to purchase *all saw logs* from the Tillamook operation".

He did not say that they would buy the *peelers* and they did not buy *the peelers* (Tr. 180-181). He did not say that they would take all the logs *in the future*. Holm testified that they didn't buy peelers after May because

> "it wasn't a type of logs that we wanted for our plant at Tacoma". (Tr. 188).

He didn't want to buy any peeler logs in May, June, July, and August

> "because they wasn't logging in suitable timber at that time. And we had a man on the operation to notify us of the type of logs were going in." (Tr. 188-189).

Obviously, if the option had been converted into a contract, Buffelen would have been compelled to take all the logs and not select what they would take and what they would leave.

In August, 25th or 26th, Bradeen was instructed to tell Glaser that they wanted raft 44 M

> "And all other peeler rafts *until further notice.*" (Tr. 196).

The instruction that they would take peeler logs *"until further notice,"* is inconsistent with an absolute contractual obligation to purchase all of the logs. Buffelen reserved the right to determine what logs it would take and when. This is not a binding contract of purchase.

Buffelen made no *written* election to exercise the option to purchase all logs until the timber was exhausted at any time or any written election at all. The first written communication demanding logs was the letter of November 3rd (Tr. 242) and the letters of November 23rd and December 24th (Tr. 243-244) while this action was pending. These three letters do not constitute an unequivocal election to take "all" logs until the timber is exhausted. The letters are carefully phrased to avoid

such construction. The letters were written by Mr. Dezendorf, the able Counsel for Buffelen. He knew how to word an unequivocal election to exercise an option. The phrase

> "This is official confirmation of Buffelen's *continued desire to avail itself of the option* to purchase all logs . . ."

especially when read in conjunction with the letter of December 24th (Tr. 244), demonstrates that they did not intend these letters to be an unequivocal election. It is merely *an expression of the desire to keep the option alive* and not to convert the option into a contract. In the letter of December 24th, Buffelen asserts that they refuse to accept Raft 64 M because they had no opportunity to inspect the raft. It said that they

> "cannot decide whether to purchase a log raft without an opportunity to inspect."

It is obvious that Buffelen wanted to remain on a selective basis to determine when and what logs they would purchase.

The case of Southwest Pipe Line Co. v. Empire Natural Gas Co., 33 F. 2d 248, cited by Appellee, has not the slightest resemblance to the case at bar. In that case, the parties *had a binding contract and not an option.* The contract was for the purchase and sale of natural gas to be taken by the purchaser on the land at the well head, coupled with an easement to the purchaser to go on the land and make extensive installations thereon with the well for the receipt and transmission of gas and storage thereof. The Court held that the contract "grants a present interest in the land" which

equity can protect by injunction. It was pointed out that the contract was not merely for the sale of gas after it was severed from the land. The purchaser was to take the gas from the land at the well and this, coupled with the easements, created the interest in realty. It would be analogous to a contract for the sale of standing timber. It has no analogy to a contract or option for the purchase of logs *after they are severed,* which is personalty. The Court also held in that case that

> "natural gas is not obtainable in the general market as is wheat, corn, flour and livestock."

This is not true of logs which can be purchased on the open market.

The equitable principle that

> "A party taking with notice of an equity, takes subject to that equity"

was used with respect to notice of an interest in realty, which will be protected in equity, but has no application to notice of an option to purchase personalty.

Appellee attempts to avoid consideration of the question whether the Court had equity jurisdiction to make the decree by asserting that the question was waived. It is our understanding that the question of whether the Court of Equity has jurisdiction, is never waived. If the case, as made out, presents no cause of equitable cognizance, the Court was without jurisdiction to issue any injunction.

CONCLUSION

For the reasons assigned in the Opening Brief and in this Reply Brief, the decree and the judgment entered herein, should be reversed and the complaint dismissed.

Respectfully submitted,

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Attorneys for Appellant,
McKenney Logging Corporation.

No. 14188

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

REPLY BRIEF OF APPELLANTS EINAR GLASER and DOROTHY GLASER

Appeals from the United States District Court for the District of Oregon.

S. J. BISCHOFF,
LEO LEVENSON,
Attorneys for Appellants Einar Glaser and Dorothy Glaser.

STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 9-54

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TABLE OF CASES AND STATUTES

No. 14188

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REPLY BRIEF OF APPELLANTS EINAR GLASER and DOROTHY GLASER

Appeals from the United States District Court for the District of Oregon.

I.

Re: Appellee's Point II Response to Appellants' Contention that the Transaction was a Mortgage.

Appellee points to an inaccuracy in Appellants' Brief in which it was stated that Appellants' own property was

transferred to Buffelen as additional security. The statement is erroneous in part insofar as it says that the land was transferred to Buffelen. But it is an accurate statement in all other respects because Appellants' timber lands were included in and made subject to the contract. The contract recites specifically (Tr. 128) that the Loggers

> "are the owners of either the fee title or the contract logging rights for the area described in Schedule 'C' attached hereto and made a part hereof, and signed for identification by the parties hereto".

The Schedule "C" (Tr. 145) lists and describes the property of Mr. and Mrs. McKenney and Mr. and Mrs. Glaser. This property, along with the property purchased with the "advances", is expressly made subject to the provisions of the contract and constituted security, the same as the Belding property described in Schedules "A" and "B" which were purchased with the advances. The use of the word "transferred" was an inadvertence.

Finding of Fact No. IV (Tr. 87), which is based on Stipulation No. IV in the Pre-trial Order (Tr. 12), reads:

> "By June of 1950 Defendants McKenney and Glaser had repaid Plaintiff all *loans and advances* made to them by it; *including Plaintiff's loans and advances for the purchase of the timber lands and cutting rights covered by the contract* which is Plaintiff's Exhibit 1, together with the interest thereon."

The finding of fact establishes that the relationship was that of debtor and creditor, and mortgagor and mortgagee with respect to the timber lands paid for in part with money advanced by Buffelen.

The Contracts, Exhibit 24 and Exhibit 1, both confirm the fact that the Loggers were in a distressed condition which resulted in the application of a loan. The Loggers had signed a contract to purchase the Belding and Scritzmeier timber prior to the contract, Exhibit 24. After they had logged part of the timber and paid part of the purchase price, it was recognized that they would be unable to pay the balance of the purchase price on or before December 31, 1946, and would forfeit that contract and their interest in the timber lands if the payment was not made at that time. It was in that situation that McKenney went to Buffelen

> "to get the money to buy this timber. Well, I considered quite a while, because I could lose my shirt. But their relations had been good, and their money was as good as anyone else's, so they advanced some money to buy this timber." (Tr. 282).

This is the money that is referred to and paid for the timber referred to in the Contract, Exhibit I.

McKenney went to Buffelen for the money because he had been borrowing money from Buffelen for some time prior thereto. The contract, Exhibit 24, was entered into for the purpose among other things, of securing the loan with which the Belding timber (the very timber involved in this case) was purchased (Contract, Exh. 24; Tr. pp. 557-8).

The contract provides that the logger

> "will secure such advance by . . . transferring title to such timber so acquired to the Lumber Company."

The arguments advanced by Appellee that the transaction did not originate in a loan and there was no

economic duress and that Buffelen paid the entire purchase price, are dissipated by this very contract under which the money was advanced and the Belding and Kritzmeier properties were acquired. It demonstrates beyond question the materiality and relevancy of the contract (Exhibit 24) upon the issue whether the transaction was a mortgage.

The contract, Exhibit 1, itself refers to and recognizes that it had its origin in an earlier contract. When the two are read together, it is readily apparent the Exhibit 1 is but a revision or modification of Exhibit 24.

It is no wonder that Appellee urges the Court to close its eyes and ignore the existence of the contract, Exhibit 24.

Exhibit 24 was not excluded for lack of proof of authenticity or any other ground except that it was "entirely immaterial". (Tr. 555). No objection to the introduction of that exhibit as evidence was made on any ground (Tr. 555) except

> "that agreement was superseded by the January 8, 1948, contract". (Tr. 555).

Appellee cannot now urge that it was inadmissible for any other reason than materiality. Appellants do not claim that the contract, Exhibit 24, is in force or that it was not superseded by the contract, Exhibit 1. It is only contended that Exhibit 24 is material and relevant as bearing upon the *interpretation of the contract and the intention of the parties.*

For that purpose, all prior negotiations, contracts, circumstances, etc. are material and relevant in a case of this kind.

Umpqua Forest Ind. v. Neenah-Oregon Land Co., 188 Or. 605; 217 Pac. 2d 219.
59 C.J.S. 77, Sec. 40.

The money with which the Belding and Kritzmeier properties were purchased and title acquired, was not advanced under the contract of January 8, 1948. The money was loaned and the title was acquired under the contract of May 22, 1946, and the title was taken in the name of Buffelen to "secure such advance". (Tr. 559).

It is not true, as argued by Appellee, that the instrument itself (Exh. 1) is controlling on the question whether the transaction was a mortgage. The ultimate question is determinable from a consideration of

> "the previous negotiations of the parties, their agreements and conversations, and the course of dealings between them prior to and leading up to the deed in question."

59 C.J.S. 77; *Umpqua Forest Ind. v. Neenah-Oregon Land Co.,* 188 Or. 605. (Appendix p. 4, former Brief.)

In cases of this character

> "we must look at the essential nature of the transaction and not play upon phrases . . . If this was their contract (loan with security) the form in which they have cast the agreements, is immaterial." (*Dollar Case,* Appendix p. 2, former Brief).
>
> "It is a question of the intention of the parties and not the form of the words or of the instrument". Hall Case. (Appendix p. 3, former Brief).

It is argued that there is no evidence that McKenney owed a debt on the Belding contract. The very money that Buffelen advanced was

> "to complete the payment of the balance due for such Belding timber," (Tr. 559).

and the transfer of title to Buffelen was made to "secure such advance". (Tr. 559).

It is argued that there was no debt to be secured and that without a debt, there can be no mortgage. This contention is contrary to finding of fact No. IV (Tr. 87).

Appellee would expunge from the contract, the provision that

> "the Loggers are indebted to the Lumber Company for advances made to them"

that $5.00 a thousand is to be deduced from the purchase price of logs

> "until all of the money advanced or subsequently to be advanced by the Lumber Company . . . has been paid . . . plus interest at the rate of 4%" (Tr. 130).

and it would expunge the provision (Tr. 131), that

> "In the event, however, when the timber of the Lumber Company is all logged, the Logger shall pay to the Lumber Company any additional amount required to reimburse it for the total cost of its holdings. . . ."

In the face of findings of fact No. IV and the provisions of the first and second contracts, and other circumstances developed by the evidence. the conclusion No. V (Tr. 91) that the transaction was not a loan and security transaction, is clearly erroneous.

The argument on page 27, Appellee's Brief, that the advances do not

"relate to that timber"

is clearly contrary to the finding of fact No. IV.

Appellants do not contend that the 1946 contract is still in force, but it is relevant upon the question of the intention of the parties to the transaction. For the purpose of presenting the intention of the parites, the two contracts must be read together. The second contract carries out the intention of the first contract as to the relationship which the parties bear to each other. It recognizes that Buffelen made advances (loans). As between Buffelen and the Loggers, the monies paid to the vendors constituted advances for the account of the Loggers and both contracts create an obligation to re-pay all the advances. This includes the money advanced for the purpose of lands as well as monies advanced for other purposes and all expense incurred by Buffelen.

Re: Appellee's Point III - Contention That Partners are Liable for $50,000.00 for the Removal of Logs by the Corporation.

Appellee prefaces the argument with an erroneous statement of Appellants' contention. Appellants do not contend that the "prepayment of stumpage" executed the contract. The Logging Company did not pay or prepay for any "stumpage." They did not buy any "stumpage." They merely re-paid to Buffelen the loans and advances that were made to pay the balance of the purchase price of the Belding Timber and other loans (Finding of Fact No. IV, Tr. 87).

The Partnership did not become the equitable owners of "Buffelen's timber" by reason of the payment. The partners were *at all times* the equitable owner of the timber. It never was Buffelen's timber. Appellee merely had, in equity, a lien upon the timber lands as security for the indebtedness and the lien was discharged when the debt was paid in full.

Appellee now, for the first time, asserts a liability against the partners for the $50,000.00 *on the ground of trespass.* It now asserts (Br. 31) a

> "derivative liability of the Partnership causing the Corporation's trespass."

No such cause of action was set forth in the complaint or advanced in the Pre-trial Order. There is *no finding of fact or conclusion of law to support this contention.*

Liability for trespass as against the Logging Company, Partnership, was expressly disclaimed by Appellee (Tr. 286-7),

> "Mr. Dezendorf: If the Court please, trespass is asserted only against the McKenney Logging Corporation and not against the company. There are only two respects in which a violation of the contract is charged by the partnership. One is in respect to *attempting to assign the contract* without Buffelen's consent, which is expressly prohibited, and the other is in *failing to give Buffelen* the *first option to buy logs* produced from the properties. *Performance* by the company, the partnership, *of all other conditions of the contract is admitted in the case.*"

The aforesaid statement of record clearly precludes the contention now made that the partners are subject to direct or "derivative" liability for *trespass.*

Paragraph V of the Pre-trial Order (Tr. 14) states Plaintiff's contention as to the liability of the Partnership as follows:

"(a) by reason of the *failure to tender* to plaintiff for purchase *logs* produced by them from the lands covered by the contract, and

(b) by reason of the *attempted sale* and conveyance to defendant McKenney Logging Corporation."

There is not the slightest intimation in the Pre-trial Order that the partners are being charged with liability in tort for trespass, derivative or otherwise, or for removal of timber.

The Corporation alone is charged with trespass in the contentions set forth in the Pre-trial Order (Par. VI, Tr. 14).

Finding of Fact No. X (Tr. 88) sets forth that the Corporation cut and removed timber. It does not charge the partners with cutting and removing timber, nor is there any finding of fact which would charge the partners with the so-called "derivative" liability. There is no consensual relationship between the Logging Company and the Corporation that would subject the Partnership to liability for the Corporation's acts.

The Authorities, cited by Appellee, do not support its contention that the Partnership is subject to a "derivative" liability for trespass. The cases and texts, re-

ferred to, do not involve cases in which timber is cut by the beneficial owner of the land in possession.

In 63 C.J. 934, Sec. 77, the text says:

> "One who merely sells property to which he has no title is not liable for trespass committed by his vendee."

In 52 Am. Jur. 862, Sec. 33, the text says:

> "As a general rule, one who merely sells property to which he has no title is not so liable. Hence, where land belonging to another is conveyed, the seller is not, by the mere sale, liable for trespass by the purchaser."

The reference to the Annotation in 127 A.L.R. 1016, deals with

> "sale of *timber on another's land*".

In the case at bar, there was no sale of the timber. The Partners sold to the Corporation all of the timber lands in which they had the equitable ownership. It was not a contract to cut and remove timber from lands which the Vendor did not own.

The applicable part of the *Annotation* appears at page "1019", titled "Sale or lease of *land* Belonging to Another". The text says:

> "Where *land* belonging to another is conveyed, it seems that the seller is not, by the mere sale, liable for trespass by the purchaser."

And cases are cited in support of that text.

In the case of *Greek Catholic Congregation v. Plummer,* 127 A.L.R. 1008 - 12 Atl. 2d 435 (Pa.), which precedes the Annotation, the Court held that the grantor

can only be held where the *grantor actively participates* in the commission of the trespass as, for instance, where the grantor directs the removal of the timber or supervises its removal, or receives the proceeds from the sale of the timber which is removed.

The Court, in that case, cites and quotes from the Restatement of the Law of Torts, Section 158, page 363, Comment I, as follows:

> " 'if the actor has commanded or requested a third person to enter land in the possession of another, the actor is responsible for the third person's entry if it be a trespasser.' "

The Court also quotes from the decision of the Supreme Court of Newfoundland as follows:

> " '*A mere sale of property,* to which a man has no title, *does not of itself carry with it a cause of action* against the seller, *even though the purchaser subsequently trespasses* on and converts the property to his own use. It must first be proved that the defendants actually took possession of the property in question, or exercised actual dominion over it, or delivered it to the trespassers in some other manner than by the mere delivery of a document purporting by its alleged construction to convey a title. In order to fasten a liability on defendants in this action for legal damage . . . *these defendants must have actually* by *themselves, or their agents* or *servants, wilfully trespassed upon the plaintiff's property,* and taken down the house and converted the goods to their own use, or wrongfully deprived the plaintiff of them.' "

In the case at bar, there is not a scintilla of evidence of the participation of the Partners in the cutting and removal of timber or of the commission of any of the

affirmative acts of the character referred to above and there is no finding of fact to that effect.

In the Annotation in LRA 1918 (D), 220, cited by Appellee, the text says (p. 223):

> "But where the land itself is conveyed it seems that the seller is not, by the mere sale, liable for trespass by the purchaser."

In any event, Buffelen could only recover for trespass upon the strength of its own ownership of the "logs" removed and not upon the weakness of the Defendants' title thereto. We have already demonstrated that Buffelen was not the owner of either the land, the timber thereon, or the logs cut from the timber after the indebtedness was paid. It only had a questionable subsisting option to buy logs. The logs removed were not the property of Buffelen and it cannot recover the value of the logs.

In *Fordson Coal Co. v. Kentucky River Coal Corporation,* 69 F. 2d 131 (Sixth Cir.), the Court held:

> "It is clear that under the law of Kentucky one who neither cuts nor removes timber from, nor commits any trespass upon, the land of an adjoining landowner, *but merely sells the timber thereon* to another, who alone cuts and removes it, is not liable to the adjoining landowner in an action of trespass for the value of the timber so removed, and for damages growing out of its removal. York v. Hogg, 171 Ky. 599, 603, 188 S.W. 663; Kentucky Harlan Coal Co. v. Harlan Gas Coal Co., 245 Ky. 234, 244, 53 S.W. (2d) 538. It was held in both of these cases that there is no relation of principal and agent, or privity of interest, between vendor and vendee; that the vendor's liability arises only out of his contract of sale, and the deed made pursuant

thereto, and such liability is not susceptible to the construction that the vendor authorized, advised, encouraged, incited, or procured the commission of the trespass, though a lessor who vests the right of privilege in a lessee to cut timber on land covered by his lease, reserving royalty to himself, may occupy a different position in relation to a trespass committed by the lessee."

Re: Appellee's Point IV.

Under Point III, Appellants Glaser and Glaser contend that the Court erred in awarding judgment against them in the sum of $118,000.00 for alleged failure to supply logs for the operation of the Batterson Mill.

It is not true, as Appellee asserts, that Appellants do not deny that Buffelen demanded delivery of logs and that Appellants failed to deliver them. Defendants Glaser and the Corporation have maintained throughout that there was no refusal on their part to deliver logs.

It is established beyond question by Appellee's own witness, Gansberg (Tr. 468 to 474), that the Batterson Mill had sufficient logs to operate on a one shift (contractual) basis from January to October 1952—the period in question.

It is not true that Gansberg's testimony to this effect was due to any misunderstanding. His testimony to this effect was clear and unequivocal. He testified on direct examination (Tr. 468):

"Q. What is the fact as to whether or not you were able to get all the logs you needed to operate the Batterson Mill after *January* 16, 1952?

A. Well, we were able to get enough logs to run on a one shift basis. . . ."

On cross-examination, he testified (Tr. 470):

> "Q. Did I understand your answer to be that you were able to get enough logs in this period from *January until the present time* to operate on a one shift basis?
>
> A. Yes. That was due partly to *mill breakdowns* and then also when the logging would continue, we would be able to gain on the inventory that way. . .
>
> . . . . .
>
> Q. How many months did the mill operate since *January* of this year?
>
> A. I believe the operation started in April and it was down for a time because of the *strike and* then down for a time in October because of lack of logs due to no logs being put in because *the loggers were shut down.*
>
> Q. They were shut down on account of *fire weather?*
>
> A. That is right. Yes. . . . (Tr. 474).
>
> Q. How many shifts did you operate?
>
> A. One.
>
> Q. *One shift straight through during all the time* that you were operating. Is that correct?
>
> A. No. There were shutdowns for *strike* and *fire weather.*"

This testimony from Plaintiffs' own witness, demonstrates beyond question that during all of the time from January to October 1952, the mill had enough logs to operate on a one shift basis and that the shutdowns during that period of time (from January to October) were due to fire weather, strikes, breakdowns, etc. and *not to lack of logs.* There is not a word of testimony in the record that during that period when the mill could operate, that it had to be shut down for lack of logs. The shutdown during part of January, February and March is not attributed by Gansberg to the inability to obtain logs.

The lack of evidence to establish that the Batterson Mill could be operated at a profit from January to October 1952 on a one shift basis, or any basis, is fully discussed in the Opening and Reply Briefs of Appellants McKenney and in the Opening and Reply Briefs of the Corporation. The arguments are adopted by Appellants Glaser and will not, therefore, be discussed further at this point.

Buol's and Carr's testimony that they offered to sell logs to Buffelen is confirmed by the testimony of Buffelen's Vice President Pohlman, its Division Manager of raw materials, Holm, and by Gould who operated the mill part of the time.

Pohlman testified (Tr. 373) that when Buol and Carr came up to Tacoma on September 27th, that Carr told him that "the purpose of their visit was to sell us logs," and at the same meeting, they discussed at length, details of submission of scale sheets and invoices for logs (Tr. 375 to 377).

Gould testified (Tr. 229) that

> . . . Everything was very harmonious, he (Buol), agreed that he would promptly start supplying the mill with logs. . . ."
>
> "Q. You testified that they had agreed to deliver logs?
>
> A. That is right."

Holm testified (Tr. 258), that at the conversation on September 27, 1951, when Buol and Carr came up to Tacoma, that

> "they said they came to Tacoma, wanting Buffelen as a customer, or something in those words."

This testimony confirms Buol and Carr's testimony that they wanted and offered to sell their logs to Buffelen and contradicts the assertion that the offer to sell logs to Buffelen rests on

> "discredited testimony of Defendants Buol and Carr".

It is asserted in a rather apologetic way that

> "Moreover, they were strangers to Buffelen and no reason is suggested why Buffelen should deal with them rather than the Partners with whom it had an existing contract for the same logs." (Br. p. 53).

For the purpose of determining whether Appellee is entitled to recover for loss of profits allegedly due to inability to obtain logs for the operation of the Batterson Mill, it is immaterial whether the logs were offered by the Logging Company or the Corporation. It presented an opportunity to obtain logs for the operation of the mill and any loss sustained would be due to Buffelen's refusal to purchase the logs from the Corporation and not from refusal to sell logs.

There is conclusive evidence in the record supplied by Appellee itself, that logs were, in fact, tendered by the Corporation and accepted by Appellee. But the transactions were not consummated because in the one instance (raft 46) Appellee sent the check in payment to the Logging Company instead of the Corporation and it was returned for that reason. Appellee did not thereafter tender the check to the Corporation (Exh. 4, Tr. 154 to 156). In the other instance, Appellee sent checks totaling approximately $70,000.00 in payment of logs,

but attached a condition to the acceptance of the checks, that the acceptance be without prejudice

> "to Buffelen's right to declare a forfeiture of the contract involved in the above action." (Tr. 242).

It is apparent that the controversy does not stem from the refusal to sell logs to Appellee, but from the controversy that arose by reason of the injection of Gould as a purchaser of the logs. It was only a few days after the conversation regarding Gould as a purchaser of logs that this law suit was commenced on October 15, 1951 (Tr. 6).

Consequently, there is no basis for the contention that loss was sustained from failure to supply logs for the operation of the Batterson Mill.

Re: Appellee's Point V.

Under Point IV, Defendants Glaser contend that the failure to obtain the written consent of Buffelen to the transfer of their interest in the timber lands to the Corporation, did not constitute a breach of the contract and does not warrant the setting aside of the transfers, on the ground

(a) that the provision prohibiting a transfer of the properties without the written consent of Buffelen, became inoperative after the indebtedness had been paid and Buffelen became merely the holder of the naked legal title IN TRUST for the Logging Company; and

(b) that in any event, Buffelen acquiesced in the transfer and did not at any time prior to the commencement of this action object to the transfer of title to the Corporation.

The latter contention has been discussed at length in Point IV of the prior Brief of Appellants Glaser and Glaser and will not be pursued further except to say that the assertion made by Appellee (p. 38) that

> "the *decision* to reject the Corporation and enforce the contract was made only *after* the Corporation's Attorney informed Mr. Neal that the Corporation had taken the timber free of Buffelen's rights under the contract",

is without supporting evidence. There is no evidence in the record of any communication, oral or written, subsequent to the communication between Mr. Neal and Mr. Griffin constituting a rejection of the Corporation as transferee of the properties and it is conceded in that statement that there was no rejection before.

Of course, the Corporation acquired the property freed of the lien created by the contract because Buffelen no longer had any mortgagee interest in the property. The only surviving right under the contract, if any, was the option to purchase logs. This option, if surviving, would not preclude a sale of the partners' interest in the lands.

There was no rejection of the Corporation by Buffelen at any time. On the contrary, the whole course of procedure from September 27th, 1951, the moment that Buffelen became aware that the Corporation had acquired the property to the time that the action was commenced, October 15, 1951, is consistent only with its willingness to do business with the Corporation; that the transfer without the written consent, was not even men-

tioned or put forward as an objection to the transaction of business.

It is argued that no forfeiture is asserted because the partners have no interest in Buffelen's land, and that none was necessary (Br. 39). This argument is, of course, predicated on the erroneous premises that Buffelen was the beneficial owner of the land which we have demonstrated is not true.

We are concerned at this point with the effect of the provision against transfer of the property without written consent in *the absence of specific provision creating a forfeiture for violation of that provision.* We have heretofore demonstrated that in the absence of such a provision the Logging Company's interest in the lands as beneficial owner thereof, could not be forfeited for the transfer of the properties without written consent even if there had been no acquiescence.

The case of *Coquille M. & T. Co. v. Dollar Co.,* 132 Or. 453, is not at all in point. The essential facts are the converse of those in the case at bar. In that case plaintiff was at all times the owner, legal and equitable, of timber lands. It entered into a contract with Defendant's Assignor which the Court held constituted merely

> "a permit or license which authorized the Randolph Company or its Assignee to enter upon the premises and cut the timber",

at a given price per thousand. The Court held that this did not create in the Defendant's Assignor or the Assignee, any interest in the land. They were merely to pay for "logs" as and when they were cut.

> "It was not required to pay for the logs until after the trees were felled."

The Court held that the license to cut logs terminated, according to its terms, at a given date and that thereafter the Defendant had no further right. It was under these circumstances that the Court held that

> "his right terminates at the conclusion of the term even though timber remains upon the land and the contract contains no provisions for a forfeiture:"

In the case at bar, the Logging Company, and later the Corporation, was the beneficial owner of the lands and timber thereon and it is the Buffelen Company that is seeking a forfeiture of their beneficial ownership of these timber lands in the absence of a provision for forfeiture in the contract as a penalty for transferring Defendants' own lands without its written consent.

Re: Appellee's Point VI.

There is no inconsistency between the contention of Appellants that the option to purchase logs had been abandoned, and any other contention advanced by Appellants. The contention on page 72 of Appellants' Brief was based upon the hypothetical existence of the option. It was qualified by the statement in parenthesis,

> "assuming that it had not been terminated".

Appellee's assertion that it was not obliged to take "all" of the logs—the "entire output" of logs, is contradicted by the contract. It recites the option was

> "to purchase all of the *entire output* of the Logger". (Tr. 126).

Appellee agrees to

"purchase *all* merchantable fir logs", (Tr. 131)

and to purchase

"*all* merchantable fir logs . . . which are dumped in the Company's pond . . . (Tr. 132).

The Loggers agreed

"to give to the Lumber Company at all times first right and option to purchase the *entire output* of the Loggers at market price . . ." (Tr. 134).

It has already been demonstrated that Appellee did not at any time exercise the option to take the "entire output" so as to convert the option into a binding contract enforceable by the Appellants. The option could only be exercised by an unequivocal election to take the "entire output" of logs as and when produced until the timber was exhausted. This was never done and the whole course of procedure of Appellee demonstrates that it had no intention of doing so.

If it be true, as asserted, that the timber was purchased to guaranty a log supply for the Tacoma and Batterson plants, Appellee could have accomplished that purpose by exercising the option to take the "entire output" and not leave the Logging Company at Appellee's mercy in conducting the logging operations and marketing their logs. Since the contract did not specify the time within which the option to take the "entire output" was to be exercised, the law implies that the option would have to be exercised within a reasonable time. The length of time between the making of the contract, January 8, 1948, and the transfer of the prop-

erties, September 1951, a period of over three years, is, under the circumstances, more than a reasonable period of time. The failure to purchase peeler logs at all, the failure to take all of the saw logs and the closing of the Batterson Mill for a period of three months, without taking any logs, warranted the belief that the option to take the entire output had been abandoned.

Re: Appellee's Point VII.

Contrary to Appellee's assertion, Appellants contention that the Court below erred in granting equitable relief, is not based on the proposition that the relief was "inappropriate". Appellants' contention is that there was no jurisdiction to grant any equitable relief upon the record in this case. This is based upon the ground that

(a) the record establishes that Appellee had no subsisting lien or other interest in the timber lands in question after the loan was paid, and hence, there was no equitable right to be protected or enforced by equitable relief; and

(b) the option to purchase logs (personal property) (if it survived) is not enforceable in equity. A breach of an option contract would only give rise to an action at law for the recovery of damages.

We are not concerned here with the procedural question whether Appellants waived the right to trial by jury. The question at issue at this point, is whether the Court below committed error in granting the specific equitable relief contained in the decree.

It is argued that this is a new contention and that it was waived by failure to raise it in the lower court.

The question was, in fact, raised in the Court below:

(a) The answers specifically allege:
"The complaint fails to state a claim against these Defendants upon which relief can be granted." (Tr. 6 and 8);

(b) at the close of the Plaintiff's case, Defendants moved the Court for an order of dismissal on the ground
"that upon the facts and the law, the Plaintiff has shown no right to the relief sought in the complaint." (Tr. 279);

(c) The appeal from the decree clearly presents the question whether the decree is supported by the record, both as to the equitable relief and the money judgment contained in the decree and judgment.

The question whether the Court had jurisdiction to grant any equitable relief upon the record, is never waived and was not waived in this case.

The action was brought in the Federal Court by reason of diversity of citizenship and the question of jurisdiction to grant equitable relief must be determined in accordance with the laws of the State of Oregon governing equitable jurisdiction.

In the State of Oregon, the distinction between law and equity is rigidly maintained.

> "Equitable rights must be both averred *and proved* before purely legal rights will be determined by a Court of Equity." (*Powell v. Sheets*, 196 Or. 682-697 (1952).)

The Court in that case went on to say:

> "The rules of law thus firmly established in this State preclude an examination of the questions of damages alleged in the cross bill when the proof shows there was no equity therein."

In *Glaser v. Slate Construction Co.,* 196 Or. 625-631, the Oregon Supreme Court quotes from one of its earlier decisions as follows:

> "This Court has held . . . that where there is an entire lack of matter of equitable cognizance, the objection is not waived by failure to interpose it at the proper time but it is *available at any stage* of the proceeding, a distinction being made between that kind of a case and a case which falls within the field of equitable jurisdiction but in which an element essential to complete jurisdiction is lacking."

The distinction between law and equity jurisdiction, is so well rooted in the State of Oregon, that when the Court finds that there is no basis for equitable relief,

> "no basis remained for the Equity Court to enter a money judgment." (*Barber v. Henry,* 197 Or. 172-183.)

In *Maxwell v. Frazier,* 52 Or. 183, the Oregon Supreme Court said:

> "Where there is a total absence of matter of equitable cognizance, the objection of want of jurisdiction is not waived by answering to the merits."

In *Gelinas v. Buffum,* 52 F. 2d 598 (Ninth Cir.), this Court held:

> "It may be contended that because the defendant acquiesced in the equity proceeding, she cannot now complain. But, as we have seen, such acquiescence cannot confer equity jurisdiction where, on the face of the pleadings, averments establishing equity jurisdiction are lacking."
>
> . . . . .
>
> "In the instant case, the remedy at law is not only adequate, but it is the only remedy, if any, to which the plaintiff is entitled under the pleadings."

In *Love v. Morrill,* 19 Or. 545, the Court held:

" . . . if it appears from the evidence that the real dispute between the parties is not recognizable by a court of equity, the complaint should be dismissed. The want of jurisdiction did not and could not have appeared until the evidence was taken, and therefore we fail to see how defendant is precluded from urging this question on the hearing in this court. When the facts necessary to give the court jurisdiction are stated in the complaint and are denied by the answer, the question of jurisdiction becomes one of fact, to be determined on the hearing, and is not waived; and where during the progress of the trial want of jurisdiction appears, it is the duty of the court to dismiss the bill."

In 30 C.J.S. 451, Sec. 88, the text says:

"In considering the question of waiver of an objection to equity jurisdiction, a distinction must be made between an entire lack of matter of equitable cognizance, and cases within the field of equitable jurisdiction but in which an element essential to plaintiff's right to call upon the court for relief is lacking. Where the cause or subject matter is regarded as being entirely outside the field of equitable cognizance, *the objection cannot be waived,* and is not waived by failure to interpose it at any particular time, but is available at any stage of the proceeding. This rule has been applied also to failure to comply with statutory requirements concerning a preliminary showing of equity jurisdiction. In statement the rule has been restricted to lack of equity apparent on the face of the bill; *but it applies also when on final hearing plaintiff wholly fails to make out any case of equitable cognizance.*"

This text is supported by a great many decisions, including decisions of the Supreme Court of the United States; decisions of this Court, and Oregon decisions.

In the case at bar, at the conclusion of the entire case, the record established that Appellee had no right, title or interest in and to the timber lands involved; that the equitable lien which it had as security for the indebtedness, has been extinguished and that it held the naked legal title as Trustee for the Appellees. Consequently, there was no subsisting equitable right to be protected or enforced by a court of equity. Insofar as the decree grants equitable relief, is clearly erroneous.

The cases cited by Appellee in support of its contention of waiver, do not involve the question of whether the jurisdiction of the Court to grant equitable relief is warranted by the record. In citing the cases, Appellee omitted to call attention to the limitation which the Courts place upon the rule of waiver, pointed out in a number of the cases cited.

For example, *Cobban v. Conklin,* 208 Fed. 231 (Ninth Cir.), cited by Appellee, the Court took the precaution to quote from the decision of the Supreme Court of the United States in the case of *Reynes v. Dumont,* 130 U.S. 354, that

> "the above rule (regarding waiver) must be taken with the qualifications that it is competent for the Court to grant the relief sought and that it has jurisdicion of the subject matter."

The rule of waiver is not applicable in his case.

Appellee now attempts to bolster its claim to equitable relief by asserting that it did exercise the option and that mutuality required by Oregon law is present. Appellee's references to the testimony at this point, merely establishes that Appellee did from time to time, pur-

chase some logs. But there is not a scintilla of evidence that it at any time before or after the commencement of this action, made an unequivocal election to convert the option into a binding bilateral contract to purchase the "entire output" of logs. This matter is discussed fully in the Reply Brief of the Corporation, pages 25 to 27 and the argument there presented is hereby adopted.

Appellee's contention that equity has jurisdiction to cancel the transfers from the Logging Company to the Corporation because they are a cloud on its title, is untenable because as against Appellants, it is not the beneficial owner of the property. It holds naked title in trust for the Corporation or the Logging Company.

Neither does a Court of Equity have jurisdiction to enjoin trespass as against the beneficial owner of the property who is in possession at the suit of one who merely holds the naked legal title in trust for the beneficial owner in possession.

CONCLUSION

For the reasons set forth in the Opening Brief and in this Reply Brief, the decree and judgment entered against these Appellants should be reversed and the complaint dismissed.

Respectfully submitted,

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No. 14188

In the

United States Court of Appeals

For the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company, *Appellants,*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee,*

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation, *Appellants.*

vs.

BUFFELEN MANUFACTURING CO., a corporation, *Appellee.*

APPELLEE'S PETITION FOR RE-HEARING

Appeals from the United States District Court
for the District of Oregon

HONORABLE JAMES ALGER FEE, Chief Judge

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It is apparent from the Court's opinion that erroneous factual assumptions prompted the Court to disallow $50,000 of the award made by the trial court against appellants McKenney and Glaser.

In order to demonstrate the Court's error and to permit its correction, it is only necessary to refer to and consider two paragraphs of the opinion.

We refer first to the third paragraph on page 6 of the opinion which is:

> "By whatever name it may be called, the one point that does seem to have merit is the one pressed by the McKenneys that there is double compensation here, that the sum of $118,000 overlaps the $50,000 found as against McKenneys and Glasers and tripled against the Buol-Carr Company. That is to say, if the Belding lumber [logs] (with the $50,000 price tag) along with other lumber [logs] had been delivered to Buffelen, the latter's mill would have had a $118,000 profit and nothing for stumpage under the June 1948 contract. The court gives $168,000. Thus Buffelen gets more for not processing the lumber [logs] than if it had."

We will now point out the errors in the second, third, and fourth sentences of this paragraph to prove that the conclusion expressed in the first sentence is wrong.

The Court says:

> "That is to say, if the Belding timber [logs] (with the $50,000 price tag) along with other lumber [logs] had been delivered to Buffelen, the latter's mill would have had a $118,000 profit and nothing for stumpage under the June 1948 contract."

We construe this to mean: "If logs from the Belding tract which were in Buffelen's name (which were admittedly worth $50,000) along with other logs from other tracts covered by the January 8, 1948, contract,

which were in McKenney's and Glaser's names, had been delivered to Buffelen by McKenney and Glaser as required by the contract, the Batterson mill would not have sustained a loss of profit of $118,000 [and Buffelen would have received nothing from McKenney and Glaser as stumpage under the contract]."

The bracketed portion at the end is completely immaterial because no claim has ever been made anywhere in this case that McKenney and Glaser owed Buffelen stumpage on any timber which they did or did not deliver to the Batterson mill. Buffelen admittedly had to pay the market price for all logs delivered to the mill and *the cost of such logs was taken into account in arriving at the monthly operating profit which Buffelen lost by reason of McKenney's and Glaser's failure to deliver logs to the mill* (See Exhibits 19-A, 19-B, 19-C and 22 Vol. II Tr. p. 480).

This sentence as it appears in the opinion or as rephrased above is correct, but it does not furnish support for the next sentence of the opinion, which is as follows:

"The court gives $168,000."

If this last sentence is to be construed as meaning: "The court gives $168,000 because of the failure of McKenney and Glaser to deliver logs from their hold-

ings and from Buffelen's holdings to the Batterson mill", it is completely wrong, since only $118,000 was allowed as against McKenney and Glaser for their breach of the contract in failing to deliver logs to the Batterson mill. *The $50,000 award was for a separate independent breach by McKenney and Glaser in attempting to convey away Buffelen's Belding tract, as a result of which Buol-Carr Company stole timber therefrom, admittedly worth $50,000.*

Now for the last sentence in this paragraph:

> "Thus Buffelen gets more for not processing the lumber [logs] than if it had."

Here is where the Court's error proves itself.

What did the Court allow because McKenney and Glaser failed to comply with the contract and deliver logs to the Batterson mill? $118,000, not $168,000, as the Court erroneously assumes in this paragraph.

Reference to Finding of Fact XII and Conclusion of Law XI conclusively proves our point.

Finding XII (Vol. 1 Tr. pages 88-89) is as follows:

> "Plaintiff sustained damages in the amount of $118,000 for loss of profit in the operation of its mill at Batterson, and in the amount of $50,000 for timber removed by defendant McKenney Logging Corporation (called Buol-Carr Company in the

opinion) by reason of their breach of the contract, which is plaintiff's Exhibit 1, and by the attempted sale by defendants McKenney and Glaser of their interest in the properties and rights covered by the contract, which is plaintiff's Exhibit 1, to defendant McKenney Logging Corporation." (Buol-Carr Company).

Conclusion XI (Vol. 1, Tr. p. 93):

"Defendants McKenney and Glaser are liable to plaintiff for $168,000 damages sustained by it and specified in Finding of Fact XII by reason of the breach of the contract, which is plaintiff's Exhibit 1, (and) by reason of the attempted sale and conveyance on September 1, 1951, to defendant McKenney Logging Corporation (Buol-Carr Company)."

What would Buffelen have made if McKenney and Glaser had complied with the contract and had delivered logs to the mill?

$118,000 net profit.

It is true that Buffelen would have paid McKenney and Glaser the market price for all logs delivered to the Batterson mill for processing, *but this was taken into account at arriving at $118,000 lost profit*, and by paying for logs, labor, etc., a profit of $118,000 would have been made and was lost. (See Exhibits 19-A, 19-B, 19-C and 22 Vol. II Tr. p. 480).

The fatal error which the Court has made is in failing to understand that McKenney and Glaser did *two* things, not one, and that Buffelen sustained and the trial court allowed $118,000 for one thing, and $50,000 for the other.

In other words, $168,000 was not awarded because of the failure of McKenney and Glaser to deliver logs to the mill in accordance with the contract, *only $118,000 was.*

The $50,000 award was for the other separate independent act committed by McKenney and Glaser in attempting to convey away Buffelen's Belding tract, making it possible for Buol-Carr Company to trespass upon and convert $50,000 worth of timber therefrom.

Admittedly, if all McKenney and Glaser had done was to breach the January 8, 1948, contract by failing to deliver logs to Buffelen's Batterson mill, $118,000 for loss of profits would have been the limit of Buffelen's recovery.

However, in addition to failing to deliver logs, McKenney and Glaser attempted to convey Buffelen's Belding tract to Buol-Carr Company, and admittedly Buol-Carr Company, on the basis of this attempted conveyance, entered on the Belding tract and removed $50,000 worth of Buffelen's timber.

The question, therefore, is: "Are McKenney and Glaser liable to Buffelen for this separate additional independent act."

The answer is definitely, "Yes."

The cases on this question are collected in an annotation in 127 A.L.R. at p. 1016, and the rule is there stated as follows:

> "The question of the liability of a grantor or lessor of property which he does not own to the true owner for the trespass of his lessee or grantee has arisen in many cases involving the sale of timber on the lands of another. The results of these cases seem to lead to the conclusion that he who assumes to sell timber on another's land, or the right to cut it, will be liable for the trespass of the purchaser in cutting it."

At p. 566 of 34 Am. Jur. (Logs and Timber, § 116) the following appears:

> "One who assumes to sell timber on another's land may be liable to the true owner for trespass by the purchaser in cutting the timber * * *."

Now let us refer to the second paragraph in the opinion which is infected with this same error.

It is the first paragraph on page eight of the opinion and is as follows:

"The nature of the claim of Buffelen is for a breach of contract which had not been rescinded by Buffelen for the breach. The court found a breach. As set forth in the Restatement of Contracts, Sec. 329, where a right of action for breach exists, compensatory damages will be given for the net amount of the losses [caused] and the gains prevented. The loss of mill profits meets this test. But if this contract had been performed by McKenney & Glaser, there would have been no payment by McKenney & Glaser for the timber. Therefore, for the McKenney & Glaser breach there *cannot* be compensation charged against them for the timber. To permit it, would be to make the claim against McKenney & Glaser half tort and half contract or half rescission and half affirmance. Therefore, $118,000 is all plaintiff is entitled to recover as against McKenney & Glaser."

Now let us consider the first sentence of this paragraph:

"The nature of the claim of Buffelen is for a breach of contract which had not been rescinded by Buffelen for the breach."

This is true, *but* McKenney and Glaser were guilty of *two* breaches, not one.

They refused to supply logs to the Batterson mill, causing the $118,000 loss of profits, *and* they attempted to convey away Buffelen's Belding tract to Buol-Carr

Company, which stole $50,000 worth of timber therefrom.

Now for the second sentence: "The court found a breach."

It found *two* breaches. First, McKenney and Glaser refused to deliver logs to the mill as required by the contract, causing $118,000 loss of profit, *and*, second, they breached the contract by attempting to convey Buffelen's Belding tract to Buol-Carr Company, as a result of which $50,000 worth of Buffelen's timber was stolen.

Finding of Fact XII and Conclusion of Law XI, quoted above, conclusively establish these conclusions.

The third sentence in this paragraph of the opinion is:

> "As set forth in the Restatement of Contracts, Sec. 329, where a right of action for breach exists, compensatory damages will be given for the net amount of losses [caused] and the gains prevented."

We have inserted the bracketed word "caused" in this statement to make it conform to Sec. 329 of the Restatement of Contracts, and so that its import may be correctly understood.

The trial court actually applied this rule in fixing the damages it allowed. It assessed $118,000 for loss of profits *and* $50,000 for Buffelen's Belding timber which McKenney and Glaser attempted to convey to Buol-Carr Company and which it stole.

In the next sentence of the opinion, it is said:

"The loss of mill profits meets this test."

But this is on the assumption that only *one* thing was done by McKenney and Glaser; that is, that they failed to supply logs to the mill, which caused the loss of profits.

In addition, McKenney and Glaser attempted to convey away Buffelen's Belding timber, and Buol-Carr Company, their grantee, stole $50,000 worth of Buffelen's timber.

This loss meets the test, too. The logs so removed were gone forever. Part of the timber assembled behind the Batterson mill was thus lost. The admitted value of the timber so lost was $50,000.

Under the authorities above cited, this loss was clearly recoverable, in addition to profits lost because of the failure of McKenney and Glaser to supply the mill with logs.

Now let us consider the next sentence:

> "But if this contract had been performed by McKenney & Glaser, there would have been no payment by McKenney & Glaser for the timber."

It is true that if McKenney and Glaser had supplied the mill with logs that McKenney and Glaser would not have paid Buffelen any stumpage, but by the same token, if they had supplied the mill with logs, there would have been no profit lost and no $118,000 awarded against them for lost profit. Whether McKenney and Glaser would have paid Buffelen stumpage for logs delivered is entirely beside the point.

Nowhere in this or any other law suit has Buffelen asserted a claim against McKenney and Glaser for stumpage owing on timber delivered to the mill. Instead of McKenney and Glaser paying Buffelen stumpage for timber delivered to the mill, Buffelen paid McKenney and Glaser the market price therefor, and this market price so paid was taken into account in determining what the profit of the operation of the Batterson mill would have been if logs had been supplied, and the $118,000 loss of profits was so determined.

Now let us consider the conclusion drawn in the next sentence of the opinion:

> "Therefore, for the McKenney and Glaser breach, there *cannot* be compensation charged against them for the timber."

No one has ever tried to make McKenney and Glaser pay Buffelen for logs they failed to supply to the Batterson mill. If all McKenney and Glaser had done was to fail to deliver logs to the mill, the timber reserved behind the mill would have remained intact. In addition to failing to deliver logs, McKenney and Glaser made it possible for Buol-Carr Company to steal $50,000 worth of timber out of the timber reserve behind the mill by attempting to convey Buffelen's Belding tract to Buol-Carr Company.

Which breach of the contract was in the court's mind when it drew this conclusion? If the court is talking about the *first* breach which was the failure of McKenney and Glaser to deliver logs to the mill, the conclusion is correct. Only loss of profits could be charged against them for failing to deliver logs to the Batterson mill, and that is what the $118,000 award was for.

$50,000 for the stolen timber can't be and wasn't charged against McKenney and Glaser for failing to deliver logs. Only $118,000 loss of profits was awarded for their breach in this regard.

The $50,000 award was for their separate additional breach in attempting to convey to Buol-Carr Company, Buffelen's Belding timber, as a result of which, $50,000 worth of timber was stolen by Buol-Carr Company and was thus eliminated from the timber reserve behind the mill.

Before Buffelen was willing to put in a mill in this isolated section, it wanted to be sure it had a supply of timber on which its mill could operate.

So McKenney and Glaser and Buffelen put together their timber holdings as a reserve behind the mill.

If all McKenney and Glaser had done in this case was to refuse to supply logs to the Batterson mill, $118,000 would have been the limit of their liability.

However, in addition to merely refusing to deliver logs to the mill, McKenney and Glaser breached the contract by attempting to convey to Buol-Carr Company part of the timber reserve behind the mill, as a result of which $50,000 worth of the reserve timber was lost.

Two wrongs were accomplished by them, both breaches of the contract, and they are liable for all the damages that flowed from these two breaches—$118,-000 loss of profit, and $50,000 loss from the timber reserve.

Now for the last two sentences of this paragraph of the opinion:

> "To permit it would be to make the claim against McKenney & Glaser half tort and half contract or half rescission and half affirmance. Therefore, $118,000 is all plaintiff is entitled to recover as against McKenney & Glaser."

Two breaches of the contract are involved, not one. Failure to deliver logs as required by the contract and an attempted conveyance of Buffelen's Belding tract which was a part of the reserve behind the mill, as a result of which $50,000 worth of the timber reserve was stolen by Buol-Carr Company.

There is nothing wrong in asserting two separate losses caused plaintiff by the defendants in one action. This is so even though one may be for a breach of contract and another for a tort. Federal Rules of Civil Procedure Rules 8 (a) and 18 (a); Vol. 2, Barron & Holtzoff, Federal Practice & Procedure § 504 p.p. 46 & 47; Vol. 6 Cyclopedia of Federal Procedure (3rd Ed) § 20.35.

Here, however, both claims are for breach of contract. The first for failing to deliver logs as required by the contract, the second for attempting to convey away Buffelen's Belding timber in violation of the con-

tract and without Buffelen's consent, which resulted in Buol-Carr Company stealing $50,000 worth of timber therefrom.

That the second claim is for breach of contract is determined by the authorities above cited, and also by *Lepla v. Rogers (1893) 1 Q.B. p. 31.* In the Lepla case a lease contained a covenant that the lessee would not assign or sublet the premises, or any part of them, without the consent in writing of the lessor. The lessee, without applying for the consent of the lessor, sublet the premises to a person who intended, as he knew, to use them as a turpentine distillery. The premises having been burned down by a fire arising from the use of the premises by the sublessee, the owner-lessor brought an action against his lessee for breach of contract, and the court held that the loss caused by the fire was the natural result of the breach of the contract, and was therefore recoverable against the lessee.

See also 3 Sutherland on Damages (4th edition) 3170-3174 Sec. 861.

Here Buffelen and McKenney and Glaser by the January 8, 1948, contract pooled their timber holdings as a reserve behind the Batterson mill. McKenney and Glaser covenanted not to sell or assign their interest under the contract without Buffelen's written consent.

Without Buffelen's knowledge or consent, McKenney and Glaser attempted not only to convey their interest under the contract to Buol-Carr Company, but also to convey to Buol-Carr Company, Buffelen's Belding timber which was a part of the timber reserve.

Based on the conveyance it received from McKenney and Glaser, Buol-Carr Company entered upon and cut and removed $50,000 worth of timber from the Belding tract.

The loss of $50,000 worth of timber from the timber reserve was the natural result of the breach of the contract by McKenney and Glaser and was therefore recoverable by Buffelen from them for breach of the contract, in addition to the loss of $118,000 profit for failure to deliver logs to the Batterson mill.

This analysis shows that the court's statement on the top of page 9 of the opinion; "But added together, the sum of the parts, $118,000 plus $50,000, adds up to too much compensation for Buffelen's actual damage," is also erroneous. Buffelen lost both the profit of the operation of its Batterson mill and timber from the reserve behind the mill.

Since this sentence of the opinion deals with the trial court's award against Buol-Carr Company, it is of no practical significance, since, as the court probably

suspects, Buol-Carr Company is an empty shell and no judgment against it in any amount is recoverable.

We respectfully submit that the court's opinion must be modified to restore the $50,000 award against McKenney and Glaser for loss of Buffelen's Belding timber, which will result in full affirmance of the trial court's judgment against defendants McKenney and Glaser.

KOERNER, YOUNG, McCOLLOCH
& DEZENDORF,
JAMES C. DEZENDORF,

Attorneys for Appellee
Buffelen Manufacturing Co.,
a corporation

800 Pacific Bldg.
Portland 4, Oregon

I, JAMES C. DEZENDORF, one of counsel for appellee herein, certify that in my judgment, this petition for re-hearing is well-founded and that it is not interposed for delay.

James C. Dezendorf

No. 14183

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company,

Appellants,

vs.

BUFFELEN MANUFACTURING CO., a corporation,

Appellee.

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation,

Appellants,

vs.

BUFFELEN MANUFACTURING CO., a corporation,

Appellee.

APPELLANTS' BART McKENNEY AND MARIE McKENNEY PETITION FOR REHEARING

Appeals from the United States District Court for the District of Oregon

HONORABLE JAMES ALGER FEE, Chief Judge

THEODORE B. JENSEN,
DEWEY H. PALMER and
DAVIS, JENSEN & MARTIN,
U. S. National Bank Building, Portland 4, Oregon,
Attorneys for Appellants Bart McKenney and Marie McKenney.

LEO LEVENSON,
Portland Trust Building, Portland 4, Oregon,
S. J. BISCHOFF,
Cascade Building, Portland 4, Oregon,
Attorneys for Appellants Einar Glaser, Dorothy Glaser and McKenney Logging Corporation.

KOERNER, YOUNG, McCOLLOCH & DEZENDORF,
JAMES C. DEZENDORF,
JAMES H. CLARKE,
800 Pacific Building, Portland 4, Oregon,
Attorneys for Appellee Buffelen Manufacturing Co.

STEVENS-NESS LAW PUB. CO., PORTLAND, OR 3-56

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AUTHORITIES CITED

No. 14188

United States
COURT OF APPEALS
for the Ninth Circuit

BART McKENNEY and MARIE McKENNEY, individually and as co-partners doing business under the name of McKenney Logging Company,

Appellants,

vs.

BUFFELEN MANUFACTURING CO., a corporation,

Appellee.

EINAR GLASER, DOROTHY GLASER and McKENNEY LOGGING CORPORATION, a corporation,

Appellants,

vs.

BUFFELEN MANUFACTURING CO., a corporation,

Appellee.

PETITION OF APPELLANTS, BART McKENNEY AND MARIE McKENNEY, INDIVIDUALLY AND AS CO-PARTNERS DOING BUSINESS UNDER THE NAME OF McKENNEY LOGGING COMPANY

TO THE COURT OF APPEALS AND THE JUDGES THEREOF:

Comes now the Appellants, Bart McKenney and Marie McKenney, individually and as co-partners doing business under the name of McKenney Logging Company, in the above entitled cause and presents this, its petition, for a rehearing on the matter below men-

tioned in the above entitled cause, and, in support thereof, respectfully shows:

I.

That Paragraph (1) of the Judgment and Decree herein (p. 95 Tr.) reads as follows:

> "(1) That defendants Bart McKenney, Marie McKenney, Einar Glaser and Dorothy Glaser be and they hereby are permanently restrained and enjoined from breaching the contract with plaintiff, which is Plaintiff's Exhibit 1;"

It is submitted that such paragraph (1) constitutes the entire injunction against McKenneys and Glasers under the Decree and is violative of Rule 65 (d) of Federal Rules of Civil Procedure in that the injunction is not "specific in terms" does not "describe in reasonable detail" * * * "the act or acts sought to be restrained" and reference is made to "other document" therein.

Rule 65(d) of Federal Rules of Civil Procedure requires that an injunction shall be "specific in terms; shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained * * *."

In *New York, New Haven & Hartford R. R. Co. vs. Interstate Commerce Commission,* 200 U.S. 361, 26 Sup. Ct. 272, 50 L. Ed. 515, the Supreme Court said (200 U.S. 404):

> "The contention, therefore, is that, whenever a carrier has been adjudged to have violated the act to regulate commerce in any particular, it is the duty of the court, not only to enjoin the carrier from furtherlike violations of the act, but to com-

mand it in general terms not to violate the act in the future in any particular. In other words, the proposition is that, by the effect of a judgment against a carrier concerning a specific violation of the act, the carrier ceases to be under the protection of the law of the land, and must thereafter conduct all its business under the jeopardy of punishment for contempt for violating a general injunction. To state the proposition is, we think, to answer it. Swift & Co. v. United States, 196 U.S. 375, 49 L. Ed. 518, 25 Sup. Ct. Rep. 276. The contention that the cited case is inapposite because it did not concern the act to regulate commerce, but involved a violation of the antitrust act, we think is also answered by the mere statement of the proposition. The requirement of the act to regulate commerce, that a court shall enforce an observance of the statute against a carrier who has been adjudged to have violated its provisions, in no way gives countenance to the assumption that Congress intended that a court should issue an injunction of such a general character as would be violative of the most elementary principles of justice. The injunction which was granted in the case of Re: Debs, 158 U.S. 564, 39 L. Ed. 1092, 15 Sup. Ct. Rep. 900 was not open to such an objection, as its terms were no broader than the conspiracy which it was the purpose of the proceeding to restrain. To accede to the doctrine relied upon would compel us, under the guise of protecting freedom of commerce, to announce a rule which would be destructive of the fundamental liberties of the citizen."

It is submitted that the decree herein should be appropriately modified with respect to the injunctive provisions as to the defendants McKenney-Glaser either by eliminating such provisions entirely or restricting the injunction so that specific acts are forbidden thereby.

A rehearing for that purpose is respectfully requested.

II.

With respect to the affirmance of award of $118,000 against McKenneys-Glasers for loss of profits:

Even if the injunction had been limited to a mandatory provision which would require the partnership to give Buffelen the option to purchase all logs produced from the areas covered by the contract, the effect of such mandate would be to create a mixture of damages for present loss of profits with an opportunity afforded Buffelen to recoup such loss of profits within the term of the contract.

It must be remembered that the contract (Exhibit 1) covers a specific area or specific areas containing quantities and qualities of logs readily ascertainable both in quantum and quality. So that failure on the part of the McKenney partnership to offer the logs to Buffelen at a particular time does not result in an ultimate loss of profits to Buffelen. For until the timber within the specific areas covered by the contract is all harvested Buffelen can recoup the loss it now alleges to have sustained.

No time limitation for removal exists under the contract. Buffelen did not purchase the entire output of the loggers. If the partnership could have removed the timber entirely within several months after the attempted transfer to the McKenney Corporation of course, any loss of use value of the mill would be limited to such several months had the partnership failed to offer the logs to Buffelen. The right of removal of the timber as fast

as the partnership could log is not denied. It cannot be denied for such removal is permissible under the contract.

It may be rightfully assumed that during the period for which damages of $118,000 (loss of profits based upon use value of the mill) the only timber harvested from the area standing in Buffelen's name was the timber for which the claim for $50,000 was made (2,000,000 feet). It must follow that all of the rest of such timber remained for future harvesting and offering to Buffelen in obedience to the above mentioned provisions of the injunction granted against McKenneys-Glasers. From such offering of timber Buffelen had the opportunity to recoup its alleged loss of profits of $118,000. Such opportunity is absent in the usual loss of profits case.

The contract (Exhibit 1) among other things provides (p. 137 Tr.):

> "(c) It is agreed that the timber owned by the Lumber Company shall be logged at as early a date as is consistent with the efficient logging. It is contemplated that the logging operations will require approximately five years and the intention of the parties hereto is that the timber owned by the Lumber Company shall be logged within the first two years of such period and at as early a date in such two years as it can be efficiently logged, in view of the loggers' whole operation."

The contract is dated January 8th, 1948.

So that damages measured by use value resulting in an award of $118,000 becomes mere speculation and guesswork.

Since the instant case was submitted, the case of *Parker v. Harris Pine Mills* has been decided by the Oregon Supreme Court, 61 Or. Advance Sheets 743, decided Dec. 30, 1955, 291 P. 2d 709. In that case as here was a mixture of partial loss of use with a claim for entire loss of use. The Court refused to countenance recovery for complete loss of use. The Court, of course, adhered to the rule that (61 Or. Adv. Sh. 751, 291 P. 2d 731):

> "In every case actual damages sustained must be established by evidence upon which their existence and amount may be determined with reasonable certainty. Speculative damages are never allowed."

Such adherence is particularly pertinent here in view of Appellee's rather astounding statements (p. 12 Appellee's brief answering McKenneys' brief) that the Oregon rule is contrary to the State of Washington rule as stated in the Washington cases cited by McKenneys for "In Oregon, as noted by the trial court (Tr. p. 202), the courts are extremely liberal in permitting recovery of earnings lost by reason of a breach of contract."

Further the Oregon Supreme Court in *Parker v. Harris Pine Mills* said following the above quoted part of the opinion and with respect to the factual situation calling for such statement (61 Or. Adv. Sh. 751, 291 P. 2d 713):

> "Schroeder testified that needle burning of slashings would cost $1 per thousand feet of timber cut. There was no attempt to segregate the portion of the debris which might be disposed of by needle burning, the maximum required by state statute,

ORS 477.242, from that which would require hand piling in order to dispose of it. The $2. to $2.50 figure was based on hand piling. Neither was any account taken of the slashings already disposed of by the defendant, nor of the amount of debris caused by natural windfalls.

"In Porter Const. Co. v. Berry, 136 Or. 80, 93, 298 P. 179, 184, Mr. Justice Rossman, speaking for the court said,

> ' * * * A recovery cannot be based upon mere guess work, and, when compensatory damages are susceptible of proof with approximate accuracy, the necessary evidence must be supplied. 17 C.J., Damages, Sec. 90, p. 758.'

"Also see Gardner v. Dolina, Or., 288 P. 2d 796, 816; Wintersteen v. Semler, 197 Or. 601, 636, 250 P. 2d 420, 255 P. 2d 138; Becker v. Tillamook Bay Lumber Co., 194 Or. 134, 142, 240 P. 2d 237."

Gardner v. Dolina, mentioned in the immediate foregoing quotation is reported in 61 Or. Advance Sheets 237 and was decided October 26, 1955.

With respect to the attempted recovery for full loss of use when the evidence showed only partial loss of use the Court said in *Parker v. Harris Pine Mills* (61 Or. Adv. Sh. 761, 291 P. 2d 718):

> "On the trial of the instant case, plaintiff sought to establish a loss of use of the entire Stanley Creek Range of 3,600 acres for a period of two years as above noted. However, her own evidence revealed that during the time in question she ran 200 head of sheep under the control of a sheepherder on this particular land, and also 'a few head of cattle.' Thus under her own testimony, she had some use of the premises for livestock purposes during the time of which complaint is made. 'A few head of cattle' might mean anything; ten, twenty, fifty, one hun-

> dred, or two-hundred head might well be within the limits of a 'few head of cattle'."

The Court's observation "You cannot sell the cow and have the milk too" (p. 761), is peculiarly applicable to the facts in the instant case. The award of $118,000 is not supported by substantial evidence. The plaintiff has the opportunity as above shown to recoup any loss allegedly suffered through future performance by the McKenneys within the framework of the contract, which performance has been mandated by the injunctive provisions of the decree. Buffelen thereby gets the cow and the milk too.

A rehearing on the award of $118,000 damages is also respectfully requested.

Respectfully submitted,

THEODORE B. JENSEN,
DEWEY H. PALMER,
DAVIS, JENSEN & MARTIN,
Attorneys for Appellants, Bart McKenney and Marie McKenney.

I, of Counsel for the above named appellants, do hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay.

DEWEY H. PALMER,

of Counsel for Appellants, Bart McKenney and Marie McKenney.

No. 14258

United States
Court of Appeals
for the Ninth Circuit

GLENS FALLS INDEMNITY COMPANY, a Corporation, and E. F. GRANDY, INC.,
Appellants,

vs.

AMERICAN SEATING COMPANY, a Corporation,
Appellee.

Transcript of Record

Appeal from the United States District Court for the Southern District of California, Central Division

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, California

No. 14258

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GLENS FALLS INDEMNITY COMPANY, a Corporation, and E. F. GRANDY, INC.,
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[Clerk's Note: When deemed likely to be of important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

For Appellants:

McCALL & McCALL and
ALBERT LEE STEPHENS, Jr.,

458 S. Spring Street,
Los Angeles 13, California.

For Appellee:

WOLFSON & ESSEY,
IRVING H. GREEN,

121 South Beverly Drive,
Beverly Hills, California. [1*]

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*Page numbering appearing at bottom of page of original certified Transcript of Record.

In the District Court of the United States, Southern District of California, Central Division

No. 14305-T.

AMERICAN SEATING COMPANY, a New Jersey Corporation, Plaintiff,

vs.

GLENS FALLS INDEMNITY COMPANY, a New York Corporation, E. F. GRANDY, INC., a California Corporation, and FARMERS & MERCHANTS BANK OF LONG BEACH, a California Corporation, Defendants.

COMPLAINT

Plaintiff for its cause of action against defendants and each of them, alleges:

I.

That the plaintiff is a corporation duly organized under the laws of the State of New Jersey and is duly qualified to do business in the State of California.

II.

That the defendant, Glens Falls Indemnity Company, is a New York corporation duly organized under the laws of the State of New York and doing business in the State of California.

That the defendant, E. F. Grandy, Inc., is a California corporation duly organized under the laws of the State of California and doing business in the State of California. [2]

That the defendant, Farmers & Merchants Bank of Long Beach, is a California corporation duly organized under the laws of the State of California and doing business in the State of California.

III.

That diversity of citizenship exists between all the parties plaintiff and all the parties defendant, and that the amount in controversy is in excess of $3,000.00.

IV.

That on or about the 29th day of April, 1949, the defendant, E. F. Grandy, Inc., had entered into a written contract or authorization dated April 29, 1949, in which said E. F. Grandy, Inc., agreed to act as General Contractor for the performance of work known and described as conversion of Building IS-16, U. S. Naval Ammunition and Net Depot, Seal Beach, California, under what was known as project NO6-16752, Spec. 20656, with the United States Government.

V.

That on or about the 4th day of May, 1949, said E. F. Grandy, Inc., as General Contractor, entered into a written contract with one V. L. Murphy, which contract was designated as "Sub-Contract" by the terms of which said V. L. Murphy, as Subcontractee, was to furnish all materials, labor, tools, machinery, equipment, light, power, water or other things necessary to perform and complete the plumbing and piping portion of the work as described by Section 17, Spec. 20656 Y & D Drawings

No. 417042 through 417055; that the contract price on said sub-contract was the sum of $16,667.05; that said sub-contract provided that the Subcontractee shall furnish to the Contractor a Performance or Completion Bond, which Bond was furnished by said Subcontractee in the principal sum of $16,667.05, with the defendant, Glens Falls Indemnity Company, a New York corporation, as Surety and [3] that said Performance Bond was executed by said corporation in writing on the 18th day of May, 1949, conditioned as follows:

"The condition of this obligation is such, that whereas the Obligee entered into a certain contract, with the Government, dated April 29, 1949, for conversion of Bldg. IS-16, U. S. Naval Ammunition & Net Depot, Seal Beach, California, NO6-16752, Specification 20656 and,

"Whereas, said Principal entered into a written subcontract on the 4th day of May, 1949, with E. F. Grandy, Inc., for Plumbing and Piping; per Section 17, Specification 20656, Y & D Drawings No. 417042 thru 417055.

"Now Therefore, If the principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by the Government, with or without notice to the Surety, and during the life of any guaranty required under the contract, and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions and agreements of any and

all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then, this obligation to be void; otherwise to remain in full force and virtue."

That on the 18th day of May, 1949, the said Subcontractee, V. L. Murphy, as principal, and Glens Falls Indemnity Company, a New York Corporation, as Surety, executed in writing a payment bond running to the defendant, E. F. Grandy, Inc., in the penal sum of $8,833.58, conditioned as follows:

"The Condition of This Obligation Is Such, that whereas the said Obligee entered into a certain contract with the Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, for the United States Government, dated April 29, 1949, for Conversion of Bldg. IS-16 U. S. Naval Ammunition & Net Depot, Seal Beach, Calif. NO6-16752, Specification 20656.

"Whereas, said Principal on the 4th day of May, 1949 entered into a written subcontract agreement with E. F. Grandy, Inc. for Plumbing and Piping; per Section 17, Specification 20656, Y & D Drawings No. 417042 thru 417055.

"Now Therefore, If the Above Principal shall indemnify and hold the said Obligee free and harmless from and against all loss and damage by reason of its failure to promptly pay to all persons supplying labor and materials used in the prosecution of the work provided for in said subcontract, then this obligation to be null and void, otherwise to remain in full force and effect."

VI.

That the defendants, E. F. Grandy, Inc., and Glens Falls Indemnity Company, knew or in the exercise of reasonable [5] care should have known that in order for said V. L. Murphy to carry out his contract as afore-alleged, it would be, and was necessary for him to purchase and obtain supplies and materials from this plaintiff, and that the foregoing performance bond and payment bond were written in part for the protection of this plaintiff, to the extent of plaintiff's claim as made herein.

VII.

That on or about the 1st day of June, 1949, the plaintiff, American Seating Company, under and pursuant to agreement with said V. L. Murphy, which said agreement was approved by the defendant, E. F. Grandy, Inc., furnished certain goods, wares and materials commonly described as a chemical sink, and equipment which were installed on said project and that said goods, wares and equipment were of the reasonable worth and value and of the contract price of $6,124.37.

VIII.

That said E. F. Grandy, Inc., received payment from the United States Government for the materials furnished by the plaintiff and certified to the United States Government that said materials had been paid for.

IX.

That said V. L. Murphy has failed and refused

to pay to the plaintiff the reasonable worth and value and contract price for said materials which were furnished to and used on said project, and that said E. F. Grandy, Inc., has failed and refused to pay the same, and that said defendant, Glens Falls Indemnity Company, has failed and refused to pay the same.

X.

On or about the 23rd day of May, 1949, V. L. Murphy assigned all of the proceeds due him under said subcontract dated May 4, 1949, to the defendant, Farmers & Merchants Bank of [6] Long Beach, and that said assignment was accepted by the defendant, E. F. Grandy, Inc., without notice of said assignment or said acceptance being given to the plaintiff, although the defendants, E. F. Grandy, Inc., and Farmers & Merchants Bank of Long Beach, knew or in the exercise of reasonable care should have known that said V. L. Murphy, in order to fulfill his contract, would be required to purchase from the plaintiff certain materials as hereinafter described for use in fulfilling and completing said sub-contract.

XI.

Plaintiff alleges upon information and belief that said E. F. Grandy, Inc., did pay to the defendant, Farmers & Merchants Bank of Long Beach, the sum of $6,124.34 without requiring said V. L. Murphy to furnish them with any evidence showing that the materials so furnished by the plaintiff had been paid for to the plaintiff.

XII.

That said defendant, Farmers & Merchants Bank of Long Beach, received from E. F. Grandy, Inc., the sum of $6,124.37 as trustee for the plaintiff, and has failed, refused and neglected to pay said sum to the plaintiff, although past due and demanded.

Wherefore, plaintiff prays judgment against the defendants, and each of them, in the sum of $6,-356.00, together with interest thereon at the rate of seven (7%) per cent per annum from the 1st day of June, 1949, until paid, for its costs of suit herein, and for such other and further relief as to the Court may seem proper.

WOLFSON & ESSEY,
/s/ By BURNETT L. ESSEY,
Attorneys for Plaintiff. [7]

[Endorsed]: Filed July 2, 1952.

[Title of District Court and Cause.]

ANSWER TO COMPLAINT

Comes now defendant Glens Falls Indemnity Company, a corporation, for itself alone and not for its co-defendants nor any of them, and in answer to plaintiff's complaint admits, denies and alleges:

I.

Admits Paragraphs I, II, III, IV and V of the complaint.

II.

This defendant denies the allegations contained in Paragraph VI of plaintiff's complaint.

III.

This defendant denies that it has any knowledge or information sufficient to form a belief as to the truth of any of the [12] allegations contained in Paragraphs VII, VIII, IX, X, XI or XII of plaintiff's complaint, except this defendant admits that it refused to pay plaintiff's claim.

For a Further, Separate, Affirmative Defense, This Answering Defendant Alleges:

I.

The complaint of plaintiff herein fails to state a claim against this defendant upon which relief can be granted.

Wherefore, defendant demands that the Court discharge defendant from all liability in the premises and award to defendant its costs.

Dated: August 6, 1952.

/s/ JOHN E. McCALL,
Attorney for Defendant.

Glens Falls Indemnity Company, a New York Corporation. [13]

Affidavit of Service by Mail attached. [14]

[Endorsed]: Filed August 6, 1952.

[Title of District Court and Cause.]

ANSWER TO INTERROGATORIES UNDER RULE 33

Now comes defendant Glens Falls Indemnity Company, a New York Corporation, by Roy O. Samson, who, having been duly sworn in response to the interrogatories served upon defendant in the above case makes the following answers and responses:

"1. Did your company receive any written application from either V. L. Murphy or E. F. Grandy, Inc., before or at the time you issued the Payment Bond dated May 18, 1949, referred to in Paragraph V of plaintiff's complaint?"

Answer: Yes. From V. L. Murphy.

"2. If such written application was obtained by you, please attach a copy thereof to your answers to these interrogatories." [19]

"3. Were you furnished with a copy of Section 17, Specification No. 20656, Y & D Drawings No. 417042 through 417055 of United States Government contract with E. F. Grandy, Inc., dated April 29, 1949, for conversion of Building IS-16, United States Naval Ammunition and Net Depot, Seal Beach, California?

Answer: No.

"4. If you did not receive such a copy, what effort did you make to obtain the same?

Answer: None.

"5. If you did receive such a copy, did such

copy indicate that V. L. Murphy would be required to obtain materials for the chemical sink provided in such specification from a material supplier?"

Answer: None received.

"6. Did V. L. Murphy post any security of any kind, or deposit any security of any kind, with your company before or at the time of the issuance of said Payment Bond of May 18, 1949, referred to in Paragraph V of plaintiff's complaint?"

Answer: No.

"7. If the answer to the previous question is in the affirmative, what security did you receive from V. L. Murphy, or anyone on his behalf, and do you still retain such security?"

Answer: None.

"8. Did your company receive from the American Seating Company a letter dated December 1, 1950, making demand for payment from you under the provisions of the Payment Bond referred to in Paragraph V of plaintiff's complaint?"

Answer: Yes.

"9. Who is B. McGee and what position did he or she have with your company on December 2, 1950?"

Answer: Telephone operator. [20]

"10. Did your company receive a letter from the American Seating Company dated December 22, 1950, concerning payment under the provisions of said Payment Bond?"

Answer: Yes.

"11. Did your company write and send a letter to the American Seating Company dated Janu-

ary 3, 1951, signed by Roy O. Samson concerning claim made under this bond?"

Answer: Yes.

"12. Who is Roy O. Samson and what connection did he have with your company on January 3, 1951?"

Answer: Adjuster.

"13. Did your company make an investigation concerning the non-payment to the plaintiff by V. L. Murphy or E. F. Grandy, Inc., for the materials furnished by the plaintiff under the contract referred to in Paragraph V of plaintiff's complaint?"

Answer: No.

"14. If your answer to the foregoing question is in the affirmative, what is the name and present address of the person or persons making such investigation?"

Answer: None made.

"15. Has your company had any correspondence with E. F. Grandy, Inc., or V. L. Murphy concerning the Payment Bond executed by your company on the 18th day of May, 1949, and referred to in Paragraph V of plaintiff's complaint?"

Answer: Have received no letter or other correspondence from E. F. Grandy, Inc., or V. L. Murphy concerning the Payment Bond.

"16. If the answer to the foregoing question is in the affirmative, please attach copies of all of

such correspondence to [21] your answers to these interrogatories."

Answer: None received.

Dated this 22nd day of August, 1952.

/s/ ROY O. SAMSON

State of California,
County of Los Angeles—ss.

Subscribed and sworn to before me this 22nd day of August, 1952.

[Seal] /s/ JOHN E. McCALL,
Notary Public in and for the above County and State. My commission expires April 9, 1955.

Affidavit of Service by Mail attached. [23]

[Endorsed]: Filed August 23, 1952.

[Title of District Court and Cause.]

ANSWER OF DEFENDANT E. F. GRANDY, INC.

Comes now the defendant E. F. Grandy, Inc., a California corporation, for itself alone and not for its co-defendants, nor any of them, and in answer to plaintiff's complaint admits, denies and alleges:

I.

Admits paragraphs I, II, III, IV and V of the complaint.

II.

This defendant denies the allegations contained in paragraph VI of plaintiff's complaint.

III.

Answering paragraph VII, this defendant admits that V. L. Murphy, as subcontractor, installed certain material and supplies in a building known as U. S. Naval Ammunition & Net Depot at Seal Beach, California, wherein the United States Government was the [28] owner, and this defendant the prime contractor, and V. L. Murphy the subcontractor. This defendant denies all other allegations in paragraph VII.

IV.

Answering paragraphs VIII and IX, this defendant admits that it has not paid to the plaintiff, American Seating Company, $6,124.37, or any other sum, and alleges that it paid said sum to V. L. Murphy, the subcontractor, and admits that it received all moneys due from the United States Government on said contract. This defendant denies that it has any knowledge or information sufficient to form a belief as to the truth of any of the other allegations contained in paragraphs VIII or IX of plaintiff's complaint.

V.

Answering paragraph X, this defendant admits that on or about the 23rd day of May, 1949, V. L. Murphy assigned the proceeds due him under said

subcontract to Farmers & Merchants Bank of Long Beach, California, and that pursuant to said assignment this defendant paid over all the money which thereafter became due V. L. Murphy, subcontractor, to the asignee, Farmers & Merchants Bank of Long Beach. This defendant denies all other allegations in paragraph X.

VI.

Answering paragraphs XI and XII, this defendant admits that he paid over to Farmers & Merchants Bank of Long Beach $6,124.37 as assignee of V. L. Murphy. This defendant denies that it has any knowledge or information sufficient to form a belief as to the truth of any of the other allegations in paragraphs XI and XII.

For a Further Second and Affirmative Defense, This Answering Defendant Alleges:

I.

The complaint of plaintiff herein fails to state a claim [29] against this defendant upon which relief can be granted.

Wherefore, this defendant demands that the Court discharge defendant from all liability in the premises and award to defendant its costs.

Dated: October 21, 1952.

/s/ JOHN E. McCALL,
Attorney for Answering
Defendant. [30]

Duly Verified.

Affidavit of Service by Mail attached. [31]

[Endorsed]: Filed October 22, 1952.

[Title of District Court and Cause.]

ANSWER TO INTERROGATORIES UNDER RULE 33

Now comes defendant E. F. Grandy, Inc., a California Corporation, by E. F. Grandy, who, having been duly sworn in response to the interrogatories served upon defendant in the above case, makes the following answers and responses:

"1. What is the name and present address of the officer of your corporation in charge of the project covered by the contract with the United States Government for the conversion of building IS-16 U. S. Naval & Ammunition Net Depot, Seal Beach, California?"

Answer: E. F. Grandy, President, 243 Broadway, Laguna Beach.

"2. What is the name and present address of the officer of your corporation who entered into the subcontract with V. L. Murphy, referred to in plaintiff's complaint?" [44]

Answer: E. F. Grandy, President, 243 Broadway, Laguna Beach.

"3. What is the name and present address of all employees engaging in correspondence with V. L. Murphy in connection with this contract?"

Answer: No one in the E. F. Grandy organization is engaging in correspondence with V. L. Murphy.

"4. Did the plaintiff American Seating Company furnish in connection with the building project referred to in plaintiff's complaint, certain material

and supplies of the agreed price and reasonable value of $6,124.37?"

Answer: The American Seating Company furnished to V. L. Murphy certain materials of the reasonable value of $61.37 [$6124.37*] but affiant does not know the agreed price with Murphy.

"5. Did American Seating Company furnish any materials, supplies or equipment which were installed in connection with the contract you had with the United States Government, known and described as Project No. 6-16752 [NOy16752*] Spec. 2-656 [20656*]?" Answer: Yes.

"6. If your answer is in the affirmative to the foregoing question, what materials and supplies or equipment did American Seating Company furnish or supply, which was installed in the project above referred?"

Answer: Three pieces of equipment, (a) a chemical sink, (b) a chemical table, and (c) a chemical fume hood.

"7. What was the agreed price and/or the market value of said material and supplies?"

Answer: Affiant does not know.

"8. Did your company receive a copy of the purchase order sent to American Seating Company under date of September 23, 1949, by V. L. Murphy, for the materials and supplies furnished by American Seating Company in connection with the construction of the project referred to?" [45]

Answer: Not to my knowledge, as it cannot be found in my file.

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* Pencil figures.

"9. Did you send a letter to the officer in charge of construction of this project for copies of the purchase order from V. L. Murphy to American Seating Company, for the chemical laboratory equipment which was furnished by it and installed in said project?"

Answer: Not that I remember, and none shows in my records.

"10. On what date did you make payment to V. L. Murphy and/or to his assigns for the work done pursuant to the subcontract of May 4, 1949?"

Answer: All payments made to Farmers & Merchants Bank of Long Beach under assignment by V. L. Murphy.

"11. Did you pay Murphy for his work before the materials and supplies furnished by American Seating Company were installed on the project?"

Answer: No.

"12. When did Murphy complete the work required of him under his subcontract with you? Please give date."

Answer: Date not in my records.

"13. Did you inspect the work performed by V. L. Murphy and, if so, who made the inspection? Give name and present address and date upon which such inspection was made."

Answer: Affiant looked over work from time to time, but Navy made final inspection.

"14. Who inspected the chemical sink and laboratory which was furnished by the plaintiff in connection with this project? Please give name and

present address of such inspector and date upon which such inspection was made."

Answer: Representatives of the Navy. Do not have date nor address of Inspector.

"15. Were you ever notified by Mr. V. L. Murphy, in writing [46] or otherwise, that he had paid American Seating Company for the materials and supplies furnished by it? If so, please advise whether orally or in writing. If orally, who had the conversation and, if in writing, please attach a copy of the writing."

Answer: No.

"16. Have any other claims been made against you by any material men or suppliers arising out of this same contract? If so, please give names, addresses and amounts of claim."

Answer: None.

"17. Was any investigation made by you prior to paying V. L. Murphy or his assigns as to whether or not American Seating Company had been paid for the materials and supplies furnished by it?"

Answer: No.

"18. If such investigation was made, give name and address of the person making such investigation, the date or dates when the investigation was made, and whether or not any written report of any kind was made in connection with said investigation?"

Answer: At question 17.

"19. What are the names and present addresses of any officers of the corporation or active managers for the corporation who are familiar with

the circumstances surrounding the contract with V. L. Murphy and the contract with the United States Government?"

Answer: Affiant, E. F. Grandy.

"20. Did you certify to the United States Government that all subcontractors and all material and supplies had been paid for?"

Answer: No.

"21. Do you admit that you have refused to pay to the American Seating Company, and still refuse to pay to the American Seating Company, the value of the material and supplies furnished by it in connection with said contract?"

Answer: Yes. [47]

"22. When did the United States Government accept the completed project?"

Answer: About June, 1950.

"23. When did the United States Government pay you in full for your contract? If payments were made in installments, state the time and amount of each installment.

Answer: Final payment made about June, 1950.

"24. When did you first receive notice from the plaintiff that it had not been paid for the materials and supplies it furnished? In what form did you receive this notice?"

Answer: In the latter part of 1950, after Murphy had been paid in full—by telephone.

"25. Did you ever give American Seating Company notice of the fact that the moneys to be paid by you to V. L. Murphy under his subcontract had been assigned by V. L. Murphy to the Farmers &

Merchants Bank of Long Beach? If you gave such notice, was it in writing and, if so, attach copy of the writing."

Answer: No.

"26. What is the name and present address of the person or persons employed by your company who were responsible for paying to Murphy or his assigns amounts due under his subcontract?"

Answer: E. F. Grandy, President.

"27. What was your purpose in requiring V. L. Murphy to furnish you with a bond in the sum of $8,833.58?"

Answer: For protection in the event of loss to me.

"28. How was the amount of $8,833.58 arrived at in determining the penal sum of the bond to be furnished by Murphy to you?"

Answer: Fifty per cent of subcontract.

"29. What is the name and present address of the person or persons who made the calculations which resulted in the determination that the bond should be in the sum of $8,833.58?"

Answer: E. F. Grandy. [48]

"30. In determining the price to be paid to subcontractor V. L. Murphy under the subcontract dated May 4, 1949, how was the price of $16,667.05 arrived at?"

Answer: Same amount as firm bid submitted by Murphy.

"31. How much of the contract of May 4, 1949 was for labor, and how much was for material?

What portion of the contract contemplated the installation of materials? What materials were provided for in the specifications to be furnished in connection with fulfilling the subcontract by V. L. Murphy?"

Answer: Not separated; same as installed by Murphy.

"32. In the contract of May 4, 1949, with V. L. Murphy, it provided that the subcontractor was to perform the following portion of the work: "Plumbing and piping" per Section 17, Spec. 20656, Y & D Drawings No. 417042 through 417055. Please state the provisions of said Section, Specification and Drawing numbers."

Answer: Section 17, in general, provided for the procurement and installation of plumbing material and pertinent piping; certain chemical laboratory equipment and the labor for installation.

"33. Did you consent in writing to the assignment of the moneys due under the subcontract to V. L. Murphy, to the Farmers & Merchants Bank of Long Beach, California? If you gave such consent, when did you give it and was it in writing? If in writing, attach copy of the written consent to your answers to these interrogatories.

Answer: Yes—May 23, 1949, in writing, as per attached copy.

Dated: December 5, 1952.

/s/ E. F. GRANDY

Subscribed and sworn to before me this 5th day of December, 1952.

[Seal] /s/ W. REX HOOVER,
Notary Public in and for the County of Orange, State of California. My commission expires November 4, 1953. [49]

We herewith acknowledge receipt of assignment of V. L. Murphy's Sub-Contract, dated May 4, 1949, for Plumbing and Piping, under our prime Contract NOy-16752 for Conversion of Building IS-16 to Quality Control Surveillance Laboratory at the U. S. Naval Ammunition & Net Depot, Seal Beach, California, subject to such revisions as may be required during construction.

All payments due under above described Sub-Contract will be made direct to the Farmers and Merchants Bank of Long Beach, 302 Pine Avenue, Long Beach, California, attention J. B. Ivey, Vice President.

Dated.....

E. F. GRANDY, INC.,
By .....

State of California,
County of Los Angeles—ss.

Geraldine M. Boice, being first duly sworn, says: That affiant is a citizen of the United States and a resident of the County of Los Angeles; that affiant is over the age of eighteen years and is not a party to the within and above entitled action; that affiant's

business address is: Room 920, Rowan Building, 458 South Spring Street, Los Angeles 13, California; that on the ... day of December, 1952, affiant served the within Answer to Interrogatories on the Plaintiff in said action, by placing a true copy thereof in an envelope addressed to the attorneys of record for said Plaintiff at the office address of said attorneys, as follows: Wolfson & Essey and Irving H. Green, Attorneys at Law, 121 South Beverly Drive, Beverly Hills, California, and by then sealing said envelope and depositing the same, with postage thereon fully prepaid, in the United States mail at Los Angeles, California, where is located the office of the attorneys for the person.. by and for whom said service was made.

That there is delivery service by United States mail at the place so addressed and there is a regular communication by mail between the place of mailing and the place so addressed.

/s/ GERALDINE M. BOICE

Subscribed and sworn to before me this 8th day of December, 1952.

[Seal] /s/ JOHN E. McCALL,
Notary Public in and for the County of Los Angeles, State of California. [50]

[Endorsed]: Filed December 9, 1952.

[Title of District Court and Cause.]

ANSWER TO REQUEST FOR ADMISSIONS TO RULE 36

Now comes defendant E. F. Grandy, Inc., a California Corporation, by E. F. Grandy, who, having been duly sworn in response to the interrogatories served upon defendant in the above case, makes the following answers and responses:

"1. That on September 23, 1949, V. L. Murphy forwarded a purchase order to the plaintiff, American Seating Company, for (1) the center table of the agreed price of $3392.00, (2) two No. S-1817X units of the agreed price of $2482.00 and (3) for a sink and peg board of the agreed price of $482.00."

Answer: No. Have no information on either (1), (2) or (3).

"2. That under date of September 26, 1949, the defendant [51] E. F. Grandy, Inc., sent four copies of said purchase order to the officer in charge of construction, U. S. Naval Base, Los Angeles, Long Beach, California."

Answer: Affiant remembers forwarding a purchase order, but does not remember date.

"3. That the defendant, E. F. Grandy, Inc., knew that in connection with its sub-contract with V. L. Murphy, which is the subject of this law suit, that V. L. Murphy purchased and installed materials and supplies in the building known as U. S. Naval Ammunition and Net Depot at Seal Beach,

California, and that the same was purchased from the American Seating Company and was of the agreed price of $6,124.37.

Answer: No. Did not know agreed price, if any, but did know source of equipment.

"4. That the purpose of requiring V. L. Murphy to furnish the payment bond referred to in plaintiff's complaint was obtained for the purpose of protecting the defendant, E. F. Grandy, Inc., and any suppliers and material man from any loss due to the failure of V. L. Murphy to pay such material man or suppliers.

Answer: Affiant's purpose in securing the payment bond was to protect E. F. Grandy, Inc., and no one else, against loss.

"5. That the defendant, E. F. Grandy, Inc., is indebted to the plaintiff in the sum of $6,124.37 for the materials furnished by the plaintiff in connection with the conversion of Building IS-16 U. S. Naval and Ammunition Net Depot, Seal Beach, California.

Answer: No. Not indebted to plaintiff in any sum.

"6. That Glens Falls Indemnity Company is defending the present action for and on behalf of the defendant, E. F. Grandy, Inc."

Answer: The attorney for my surety, Glens Falls Indemnity Company, is defending this defendant E. F. Grandy, Inc.

"7. That Glens Falls Indemnity Company has agreed with the [52] defendant, E. F. Grandy, Inc., that it will pay any judgment obtained by the plain-

tiff against the defendant, E. F. Grandy, Inc., in this action under the provisions of the bond as alleged in plaintiff's complaint."

Answer: No such agreement.

Dated: December 5, 1952.

/s/ E. F. GRANDY

Subscribed and sworn to before me this 5th day of December, 1952.

[Seal] /s/ W. REX HOOVER,
Notary Public in and for the County of Orange, State of California. My Commission expires November 4, 1953. [53]

Affidavit of Service by Mail attached. [54]

[Endorsed]: Filed December 9, 1952.

[Title of District Court and Cause.]

MEMORANDUM BRIEF OF DEFENDANT FARMERS AND MERCHANTS BANK OF LONG BEACH

Statement of Essential Facts

Defendant, Farmers and Merchants Bank of Long Beach, is a banking corporation, authorized to do business under the Laws of the State of California. Part of its business is the lending of its funds to borrowers, taking as evidence of said loans Notes, some of which are secured and some of which are unsecured.

On or about May 23, 1949, V. L. Murphy, being the same person as the V. L. Murphy described

in plaintiff's Memorandum Brief, being already indebted to defendant Bank for loans and advances made to him in the amount of $10,000.00, and in consideration of future loans which he, the said V. L. Murphy, required, and to secure said past loans and future advances, [65] assigned in writing to the Defendant Bank all of his right, title, interest and demand in all monies due or to become due, when and as the said monies shall have accrued, pursuant to the terms of a Sub-Contract dated May 4, 1949, by and between V. L. Murphy and E. F. Grandy, Inc., covering plumbing and piping, per Section 17 Spec. 20656, Y & D Drawings No. 417042 through 417055, with full authority to collect and receipt for the same.

Thereafter, Defendant Bank loaned to the said V. L. Murphy sums of money in excess of $46,000.00, and received from E. F. Grandy, Inc., pursuant to the Assignment above mentioned, at least the sum of $15,426.04, which amount was paid in installments at various dates, and was credited by defendant Bank on the indebtedness due it from the said V. L. Murphy. Several other credits appear on the account of V. L. Murphy, but defendant Bank cannot at this time identify whether or not said E. F. Grandy, Inc., has paid a total amount to it of $16,667.05.

Defendant Bank had no notice nor knowledge that V. L. Murphy intended to or actually did purchase any material from plaintiff, and at no time had any knowledge, until the filing of this suit,

that V. L. Murphy was indebted to plaintiff. [66]
* * * * *

Affidavit of Service by Mail attached. [68]

[Endorsed]: Filed February 3, 1953.

[Title of District Court and Cause.]

PRE-TRIAL BRIEF OF DEFENDANTS GLENS FALLS INDEMNITY COMPANY AND E. F. GRANDY, INC.

Statement of Facts

On or about the 29th day of April, 1949, defendant E. F. Grandy, Inc., as prime contractor, entered into a written contract in the sum of $100,315.00 with the United States Government for the construction of certain work at the United States Naval Ammunition and Net Depot at Seal Beach, California, and posted with the United States Government a Performance Bond and a Labor and Materials Bond, as required by an act of the Congress known as the "Miller Act", Sections 270a and 270b, Title 40, United States Codes Annotated.

On or about the 4th day of May, 1949, defendant E. F. Grandy, Inc., entered into a written subcontract in the sum of $16,667.05 [70] with one V. L. Murphy, a plumbing contractor, to do a portion of the work required by the prime contract with the United States Government. V. L. Murphy posted with E. F. Grandy, Inc., a Performance Bond and

a Payment Bond with defendant Glens Falls Indemnity Company as surety to protect it, E. F. Grandy, Inc., in the event it suffered a loss by reason of the subcontract.

All of the work under the prime contract of E. F. Grandy, Inc., including the work of V. L. Murphy under the subcontract, was completed and was accepted by the Government on or about the ... day of June, 1950. E. F. Grandy, Inc., was paid in full by the Government and V. L. Murphy, and his assignee, the Farmers & Merchants Bank of Long Beach, California, were paid in full by E. F. Grandy, Inc., on or about the 19th day of July, 1950.

On or about the 9th day of February, 1951, the plaintiff herein, American Seating Company, filed in the Superior Court of Los Angeles County, Case No. 582-886, a complaint against V. L. Murphy, and on the 6th day of March, 1952 was awarded judgment against V. L. Murphy in the sum of $6,681.78 for the same materials mentioned in this suit.

This suit which named E. F. Grandy, Inc., the Glens Falls Indemnity Company, and the Farmers & Merchants Bank of Long Beach as defendants, was commenced in this Court on or about July 2, 1952.

* * * * * [71]

[Endorsed]: Filed March 5, 1953.

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: April 1, 1953. At: Los Angeles, Calif.

Present: The Hon. Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: Fred Sherry.

Counsel for Plaintiff: Irving H. Green.

Counsel for Defendants: John E. McCall for defendant Glens Falls Indemnity Co. and E. F. Grandy, Inc. M. W. Horn for defendant Farmers & Merchants Bank.

Proceedings: For pretrial. (In Chambers).

Plf's Ex. 1 to 16 incl, are marked for ident.

Pursuant to stipulation of counsel It Is Ordered that photo copies of exhibits may be used in lieu of the originals.

It Is Ordered that facts as stipulated to by counsel, and exhibits introduced, may be deemed the evidence in this case, except those exhibits which counsel for defendants Glens Falls Indemnity Co. and E. F. Grandy, Inc., will determine as to their genuineness, and so advise the Court by letter.

Counsel for plaintiff states he will submit the case on those briefs already filed.

It Is Ordered that either party may file additional briefs twenty days after receipt of a copy of the transcript of the hearing this day, and have ten days thereafter in which to file any reply briefs.

It Is Further Ordered that in the event counsel

do not desire to submit the cause upon the filing of briefs, that trial will be had on May 8, 1953, at 2 p.m., as to defendants Glens Falls Indemnity Co. and E. F. Grandy, Inc.

Trial as to defendant Farmers & Merchants Bank will be severed and date of trial as to said defendant will be fixed after determination of the case as to defendants Glens Falls Indemnity Co. and E. F. Grandy, Inc.

Provided that the case proceeds to trial as to defendant Farmers & Merchants Bank, plaintiff is ordered to give said defendant ten days notice.

EDMUND L. SMITH, Clerk.
/s/ WM. A. WHITE, Deputy Clerk. [83]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: May 8, 1953. At: Los Angeles, Calif.

Present: The Hon: Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: Fred Sherry.

Counsel for Plaintiff: Irving H. Green.

Counsel for Defendants: John E. McCall; George Sturr; for Glens Falls Indemnity Co. and E. F. Grandy, Inc.

Proceedings: For trial as to def'ts Glens Falls Indemnity Co. and E. F. Grandy, Inc.

All parties present. Court orders trial proceed.

Plf's Ex. 17 is received in evidence.

Defts' Ex. A, B, and C are received in evidence.

Plaintiff moves the Court for leave to amend prayer of complaint.

Court orders that prayer of complaint may be amended by interlineation.

Plaintiff rests. Defendants rest.

Plf's Ex. 2 to 8 incl., and 12 to 16 incl., are received in evidence.

Court reserves ruling re admissibility of Plf's Ex. 1, 9, and 10.

It Is Ordered that both sides file briefs on or before May 20, 1953, 5 p.m., and that reply briefs be filed by May 25, 1953, the cause then to stand submitted.

EDMUND L. SMITH, Clerk.
/s/ WM. A. WHITE, Deputy Clerk. [86]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: May 27, 1953. At: Los Angeles, Calif.

Present: The Hon. Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: none.

Counsel for Plaintiff: No appearance.

Counsel for Defendants: No appearance.

Proceedings:

This cause having been taken under submission after trial as to defendants Glens Falls Indemnity Co. and E. F. Grandy, Inc.

It Is Ordered that judgment be entered in favor of plaintiff as prayed; counsel for plaintiff to draw formal findings and judgment.

Clerk will notify counsel.

EDMUND L. SMITH, Clerk.
/s/ By WM. A. WHITE, Deputy Clerk. [99]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case came on for trial May 8, 1953, the Honorable Ernest A. Tolin, Judge Presiding.

The plaintiff was represented by its attorneys, Wolfson & Essey and Irving H. Green, by Irving H. Green, and the defendants, Glens Falls Indemnity Company and E. F. Grandy, Inc., were represented by their attorneys, John E. McCall and George Sturr.

The case was presented upon the complaint of the plaintiff and the answer filed on behalf of defendants, Glens Falls Indemnity Company and E. F. Grandy, Inc.

The court, having heard all of the evidence, considered all of the stipulations of the parties and being fully advised in the premises, made the following:

Findings of Fact

1. That it is true as alleged in Paragraph I of the [112] Complaint that the plaintiff is a corpora-

tion duly organized under the laws of the State of New Jersey and is duly qualified to do business in the State of California.

2. That it is true as alleged in Paragraph II of the Complaint that the defendant, Glens Falls Indemnity Company, is a New York corporation duly organized under the laws of the State of New York and doing business in the State of California.

3. That it is true as alleged in Paragraph III of the Complaint that diversity of citizenship exists between all the parties plaintiff and all the parties defendant, and that the amount in controversy is in excess of $3,000.00.

4. That it is true as alleged in Paragraph IV of the Complaint that on or about the 29th day of April, 1949, the defendant, E. F. Grandy, Inc., had entered into a written contract or authorization with the United States Government dated April 29, 1949, in which said E. F. Grandy, Inc. agreed to act as General Contractor for the performance of work known and described as conversion of Building 15-16 U. S. Naval Ammunition & Net Depot, Seal Beach, California, under what was known as project NO6-16752, Spec. 20656.

5. That it is true as alleged in Paragraph V of the Complaint that on or about the 4th day of May, 1949, said E. F. Grandy, Inc., as General Contractor, entered into a written contract with one V. L. Murphy, which contract was designated as "Sub-Contract" by the terms of which said V. L. Murphy, as Sub-contractee, was to furnish all materials, labor, tools, machinery, equipment, light,

power, water or other things necessary to perform and complete the plumbing and piping portion of the work as described by Section 17, Spec. 20656 Y & D Drawings No. 417042 through 417055; that the contract price on said sub-contract was the sum of $16,667.05.

It is true as alleged in said Paragraph V that said sub-contract [113] provided that the Sub-contractee shall furnish to the Contractor a Performance or Completion Bond, which Bond was furnished by said Sub-Contractee, to wit, V. L. Murphy, in the principal sum of $16,667.05, with the defendant, Glens Falls Indemnity Company, as Surety and that said Performance Bond was executed by said corporation in writing on the 18th day of May, 1949, conditioned as follows:

"The condition of this obligation is such, that whereas the Obligee entered into a certain contract, with the Government, dated April 29, 1949, for conversion of Bldg. IS-16, U. S. Naval Ammunition & Net Depot, Seal Beach, California, NO6-16752, Specification 20656 and,

"Whereas, said Principal entered into a written subcontract on the 4th day of May, 1949, with E. F. Grandy, Inc., for Plumbing and Piping; per Section 17, Specification 20656, Y & D Drawings No. 417042 through 417055.

"Now, Therefore, If the principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by

the Government, with or without notice to the Surety, and during the life of any guaranty required under the contract, and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions and agreements of any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then, this obligation to be void; otherwise to remain in full force and virtue." [114]

That is is true as alleged in said paragraph that on the 18th day of May, 1949, the said Sub-contractee V. L. Murphy, as principal and Glens Falls Indemnity Company, a New York corporation, as Surety, executed in writing a payment bond running to the defendant, E. F. Grandy, Inc., in the penal sum of $8,333.58, conditioned as follows:

"The Condition of This Obligation Is Such, that whereas the said Obligee entered into a certain contract with the Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, for the United States Government, dated April 29, 1949, for Conversion of Bldg. IS-16 U. S. Naval Ammunition & Net Depot, Seal Beach, Calif. NO6-16752, Specification 20656.

"Whereas, said Principal on the 4th day of May, 1949 entered into a written subcontract agreement with E. F. Grandy, Inc. for Plumbing and Piping; per Section 17, Specification 20656, Y & D Drawings No. 417042 through 417055

Now Therefore, If the Above Principal shall indemnify and hold the said Obligee free and harm-

less from and against all loss and damage by reason of its failure to promptly pay to all persons supplying labor and materials used in the prosecution of the work provided for in said subcontract, then this obligation to be null and void, otherwise to remain in full force and effect."

6. That it is true as alleged in Paragraph VI of the Complaint that the defendants, E. F. Grandy, Inc., and Glens Falls Indemnity Company, knew that in order for said V. L. Murphy to carry out his contract, it would be and was necessary for him to purchase and [115] obtain supplies and materials from plaintiff.

That it is true as alleged in said paragraph that said performance bond and payment bond were written in part for the protection of plaintiff to the extent of plaintiff's claim as made in said Complaint and that there existed a contractual relationship relating to said Performance Bond and Payment Bond between plaintiff and the defendants, E. F. Grandy, Inc., and Glens Falls Indemnity Company, and each of them.

7. That it is true as alleged in Paragraph VII of the Complaint that on the 1st day of June, 1949, the plaintiff, under and pursuant to an agreement in writing with the said V. L. Murphy, which said agreement was approved by the defendant, E. F. Grandy, Inc., furnished certain goods, wares and materials commonly described as a chemical sink, and equipment which were installed on said project and that said goods, wares and equipment were of

the reasonable worth and value and of the contract price of $6,356.00.

8. That it is true as alleged in Paragraph VIII of the Complaint that said E. F. Grandy, Inc., received payment from the United States government for the materials furnished by the plaintiff.

9. That it is true as alleged in Paragraph IX of the Complaint that said V. L. Murphy has failed and refused to pay to the plaintiff the reasonable worth and value and contract price, to wit, $6,356.00, for said materials which were furnished to and used on said project, and that said E. F. Grandy, Inc. has failed and refused to pay the same, and that said defendant, Glens Falls Indemnity Company, has failed and refused to pay the same and that in truth and in fact the said plaintiff American Seating Company has not been paid the sum of $6,356.00, which sum was due and owing to the said plaintiff from the said defendants from and after the 1st day of June, 1949. [116]

10. That, except as hereinabove specifically found to be the facts, the allegations of the Answers herein are found to be untrue.

Based upon the foregoing Findings of Fact, the Court rendered the following:

Conclusions of Law

I.

Plaintiff is entitled to recover from the defendants, Glens Falls Indemnity Company, a New York Corporation, and from E. F. Grandy, Inc., a Cali-

fornia Corporation, jointly, as and for the reasonable worth and value and the contract price of goods furnished, the sum of $6,356.00, plus interest on said sum of $6,356.00 at seven per cent (7%) per annum from and after June 1, 1949, that is to say interest in the sum of $1,975.41, or a total sum of $8,331.41.

II.

Plaintiff is entitled to recover from the defendants, Glens Falls Indemnity Company, a New York Corporation, and from E. F. Grandy, Inc., a California Corporation, jointly, the plaintiff's costs in this action.

III.

Based upon the foregoing Findings of Fact and Conclusions of Law, the Court rendered its Judgment.

Dated: This 9th day of June, 1953.

/s/ ERNEST A. TOLIN,

Judge of the United States District Court, Southern District of California, Central Division.

Affidavit of Service by Mail attached. [118]

[Endorsed]: Filed June 9, 1953.

In the District Court of the United States, Southern District of California, Central Division.

No. 14305-T

AMERICAN SEATING COMPANY, a New Jersay Corporation, Plaintiff,

vs.

GLENS FALLS INDEMNITY COMPANY, a New York Corporation, E. F. GRANDY, INC., a California Corporation, et al.,

Defendants.

JUDGMENT

The Court having made its Findings of Fact and Conclusions of Law, and good cause appearing therefor, renders judgment as follows:

I.

It Is Ordered, Adjudged and Decreed that plaintiff shall have and recover from the defendants, Glens Falls Indemnity Company, a New York Corporation, and E. F. Grandy, Inc., a California Corporation, jointly, the sum of $6,356.00, plus interest on said sum of $6,356.00 at seven per cent (7%) per annum from and after June 1, 1949, to date of judgment, that is to say interest in the sum of $1,975.41, or a total sum of $8,331.41.

II.

It Is Further Ordered, Adjudged and Decreed that plaintiff [119] shall have and recover from the defendants, Glens Falls Indemnity Company, a New

York Corporation, and E. F. Grandy, Inc., a California Corporation, jointly, plaintiff's costs in this action.

III.

The Clerk is directed to enter judgment accordingly.

Costs taxed at $66.87.

Dated: This 9th day of June, 1953.

/s/ ERNEST A. TOLIN,
Judge of the United States District Court, Southern District of California, Central Division.

Affidavit of Service by Mail attached. [121]

[Endorsed]: Filed June 9, 1953.

[Title of District Court and Cause.]

MOTION FOR A NEW TRIAL

Now Come Glens Falls Indemnity Company and E. F. Grandy, Inc., Defendants in the above entitled cause, and move this Honorable Court for an order setting aside the judgment herein against these Defendants and granting a new trial of the above entitled cause, for the following reasons:

1. The judgment against Defendants E. F. Grandy, Inc. and Glens Falls Indemnity Company and the following findings of fact are not supported by the evidence herein, in that the following particulars are unsubstantiated:

(a) Finding 6 is not supported by any evidence

in so far as it finds that Defendants E. F. Grandy, Inc., and Glens Falls Indemnity Company knew that in order for V. L. Murphy to carry out his contract, it would be and [123] was necessary for him to purchase and obtain supplies and materials from plaintiff.

There is no evidence whatever that defendants E. F. Grandy, Inc., and Glens Falls Indemnity Company knew that Murphy would have to buy this material from plaintiff. Nor do any of the Answers to Interrogatories, herein, or Request for Admissions and their Answers herein establish this fact. Nor was the fact of this knowledge on the part of the said defendants agreed on at the pre-trial conference herein. Instead, it was specifically disputed by counsel for said defendants at said pre-trial conference (Rep. Tr. of Pre-Trial Conference, p. 12, lines 11-14). The finding of this knowledge on the part of said defendants in finding 6 is therefore completely unsupported by any evidence or admission, and it is a material question of fact, put in issue by the pleadings and at the pre-trial conference herein.

(b) Finding 6 is not supported by any evidence in so far as it finds that the performance bond, (Exhibit 3) and payment bond (Exhibit 4), were written in part for the protection of plaintiff to the extent of plaintiff's claim as made in its complaint herein.

This is a material question of fact put in issue by the pleadings herein. There is no evidence or admission or answer to interrogatories or agreed

statement of fact from the pre-trial conference herein to support this finding that these bonds were written for the protection of plaintiff. In fact, when plaintiff asked defendant E. F. Grandy, Inc., in Interrogatory number 27 of its Interrogatories of said defendant, on file herein: "What was your purpose in requiring V. L. Murphy to furnish you with a bond in the sum of $8,833.58?" the [124] said defendant answered: "For protection in the event of loss to me." (Emphasis added.)

And when plaintiff asked said defendant in plaintiff's Request for Admissions, number 4, on file herein, to admit: "That the purpose of requiring V. L. Murphy to furnish the payment bond referred to in plaintiff's complaint was obtained for the purpose of protecting the defendant, E. F. Grandy, Inc., and any suppliers and material man from any loss due to the failure of V. L. Murphy to pay such material man or suppliers," (Emphasis added) said defendant replied "Affiant's purpose in securing the payment bond was to protect E. F. Grandy, Inc. and no one else, against loss". (Emphasis added.)

These two statements of defendant E. F. Grandy, Inc. are the only two statements of any evidentiary value whatever in this case regarding this finding on the material question of fact of the purpose and intent of the said defendants in executing the said two bonds in this case. Far from supporting this finding, they completely negative said finding.

(c) Finding 6 is not supported by any evidence

is so far as it finds that "There existed a contractual relationship relating to said Performance Bond and Payment Bond between plaintiff and the defendants, E. F. Grandy, Inc. and Glens Falls Indemnity Company, and each of them." In so far as this "finding" involves a material question of fact, there is no evidence nor admission nor answer to interrogatories, nor agreed statement of fact from the pre-trial conference, whatsoever in this case to support such a finding. In any event, this statement is not properly a finding of fact; it is a conclusion of law, but a conclusion that is not based on any finding that has [125] any support whatever from the evidence in this case.

(d) Finding 7 is not supported by any evidence in so far as it finds that the said agreement in writing between plaintiff and V. L. Murphy, whereby plaintiff furnished to the said V. L. Murphy certain goods, wares and equipment, "was approved by the defendant, E. F. Grandy, Inc."

There is no evidence or admission or answer to interrogatories or agreed statement of fact from the pre-trial conference that defendant E. F. Grandy, approved said agreement.

(e) Finding 9 is not supported by any evidence in so far as it finds that $6,356.00 "was due and owing to the said plaintiff from the said defendants from and after the 1st day of June, 1949." In the first place, this is not a proper finding of fact, but is, instead, a conclusion of law, and should therefore not be a part of Finding 9. In the second place, it is not supported by any evidence, admission, an-

swer to interrogatory, or agreed statement of fact from the pre-trial conference in this case.

2. Conclusion of Law I and the judgment against defendant E. F. Grandy, Inc., are not supported by the evidence and the Court has failed to make findings sufficient to support said Conclusion of Law I and the judgment against said defendant in the following particulars:

(a) In so far as Conclusion of Law I and the judgment against said defendant E. F. Grandy, Inc., are based on the "contract price of goods furnished," the Court has failed to make any finding establishing any contract between plaintiff and the said E. F. Grandy, Inc., for the purchase and sale of the materials, on the following [126] material questions of fact which were in issue in this case:

(i) There is no finding on the material issue of fact whether plaintiff made an offer to sell and supply said materials to defendant E. F. Grandy, Inc.

(ii) There is no finding on the material issue of fact of whether defendant E. F. Grandy, Inc., accepted such an offer from plaintiff.

(iii) There is no finding on the material issue of fact of whether such an offer and acceptance between plaintiff and defendant E. F. Grandy, Inc., was based on mutually contemplated consideration passing from each of said parties to the other, or promises between the said two parties to exchange such consideration.

(b) In so far as Conclusion of Law I and the judgment against defendant E. F. Grandy, Inc.,

are based on the "reasonable worth and value * * * of goods furnished," the Court has failed to make any finding establishing any factual relationship between plaintiff and said defendant E. F. Grandy, Inc., to sustain said conclusion and judgment in the following particulars:

(i) There is no finding on the material issue of fact of whether defendant E. F. Grandy, Inc., ever requested plaintiff to furnish said goods to said defendant or anyone else.

(ii) There is no finding on the material issue of fact of whether defendant E. F. Grandy, Inc., ever promised plaintiff or anyone else that it would pay for said furnished goods.

The judgment against defendant E. F. Grandy, Inc., and Conclusion of Law I are not only not sustained by any [127] findings, as specified, but they are also not sustained by any evidence to establish facts establishing a contract between defendant E. F. Grandy, Inc., and plaintiff, or facts giving rise to a legal restitutionary right of recovery in the plaintiff against defendant E. F. Grandy, Inc., based on unjust enrichment for the reasonable worth and value of goods furnished.

3. The judgment herein is against the law, and the Court was in error in holding that defendant Glens Falls Indemnity Company is liable to plaintiff, in that:

(a) Judgment against defendant Glens Falls Indemnity Company cannot be predicated on the payment bond (Exhibit 4) herein because:

(i) This bond is conditioned solely to indemnify

and hold harmless defendant E. F. Grandy, Inc., and as a matter of law, a bond so conditioned does not give anyone a right of action thereon except the named obligee (in this case, defendant E. F. Grandy, Inc.) Plaintiff does not therefore have a right of action or a right to recover from defendant Glens Falls Indemnity Company on this bond at all. (See Points and Authorities attached hereto, citing the case of Thode vs. McAmis.)

(ii) This bond is a bond of indemnity against actual loss or damage to defendant E. F. Grandy, Inc., and even E. F. Grandy, Inc. could not recover on this bond because it has not suffered any loss or damage which it must do, as a matter of law, before it can recover on this bond, and certainly the plaintiff cannot recover on it. (See Points and Authorities attached hereto, citing Cal. Civil Code Section 2778.) [128]

(b) Judgment against defendant Glens Falls Indemnity Company cannot be predicated on the performance bond (Exhibit 3) because:

(i) The execution of a separate payment bond (Exhibit 4) precludes, as a matter of law, any recovery from Glens Falls Indemnity Company for payment of materialmen on the performance bond (Exhibit 3). (See Points and Authorities attached hereto citing Maryland Casualty Co. vs. Shafer and other California cases.)

(ii) The execution and existence of a separate statutory payment bond, pursuant to the prime contract, (Exhibit A) by the prime contractor, E. F. Grandy, Inc., and its surety under the Miller Act

(40 U. S. C. A. 270 b) precludes, as a matter of law, any recovery from Glens Falls Indemnity Company for payment of materialmen on the performance bond (Exhibit 3). (See Maryland Casualty Company vs. Shafer and other cases cited in Points and Authorities attached hereto.)

(iii) Plaintiff as a matter of law, does not have any right of action on the performance bond. No one has a right of action against Glens Falls Indemnity Company on the performance bond, except the named obligee, defendant E. F. Grandy, Inc. (See Maryland Casualty Company vs. Shafer and other California cases cited in Points and Authorities attached hereto.) [129]

4. The judgment herein is against the law and the Court was in error in holding that the following allegations in the Answers of defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., are untrue (Finding 10), and Finding 10 is not based on any evidence in the following particulars:

(a.) Paragraph II of the Answer of defendant Glens Falls Indemnity Company, and Paragraph II of the Answer of defendant E. F. Grandy, Inc. specifically denied the allegations contained in Paragraph VI of plaintiff's complaint, which said Paragraph VI alleged that said defendants knew that V. L. Murphy had to obtain materials from plaintiff.

Plaintiff's said allegation in Paragraph VI of its complaint is not supported by any evidence whatsoever nor by any agreed statement of fact from the pre-trial conference, nor by any answer

to interrogatories or admission on file herein, as pointed out in Point 1-a of this Motion For New Trial. Since the burden of proof on this issue was the plaintiff's, it must therefore be held that said defendant's denials of the said allegation in Paragraph VI of plaintiff's complaint are true and that the Court erred in holding them untrue in Finding 10, and that since this allegation of such knowledge on the part of said defendants is a material issue of fact in this case, the judgment herein is against the law.

(b). Paragraph II of the respective Answers of said defendants specifically denied the allegations contained in Paragraph VI of plaintiff's complaint, which said Paragraph VI alleged that the performance bond, (Exhibit 3) and the payment bond (Exhibit 4) were written in part for the protection of plaintiff to the extent of [130] plaintiff's claim as made in its complaint herein.

Plaintiff's said allegation in Paragraph VI of its complaint, is not supported by any evidence whatsoever. In fact it is shown to be untrue by defendant Grandy's answer to Interrogatory number 27, and by defendant Grandy's response to plaintiff's Request For Admission number 4, as more specifically set out in Point 1-b of this Motion for New Trial.

Since the burden of proof on this issue of the purpose for which the bonds were written was on the plaintiff, and since plaintiff offered no proof thereon, and since the only statements in this case regarding this point are the Answers of defendant

E. F. Grandy to the aforesaid Interrogatory 27 and Request for Admission number 4, which support defendant's said denials in Paragraph II of their respective Answers, it must therefore be held that said defendants' denials of the said allegation in Paragraph VI of plaintiff's complaint, are true, and that the Court erred in holding them untrue in Finding 10, and that since this question was of material issue of fact in this case, the judgment herein is therefore against the law.

(c.) Paragraph III of the Answer of defendant Glens Falls Indemnity Company denies on lack of knowledge or information sufficient to form a belief, and Paragraph III of the Answer of defendant, E. F. Grandy, Inc. specifically denies the allegation in Paragraph VII of plaintiff's complaint that the agreement between plaintiff and V. L. Murphy, whereby plaintiff would furnish V. L. Murphy with the materials sued for in plaintiff's complaint, was approved by defendant E. F. Grandy, Inc.

As more fully set out in Point 1-c of this [131] Motion for New Trial, plaintiff's said allegation in Paragraph VII of its complaint is not supported by any evidence whatsoever. Since the burden of proof on this question of approval by defendant E. F. Grandy, Inc., was on the plaintiff, and since plaintiff failed to prove it, and since it was never admitted by said defendants, it must be held, therefore, that said defendants' denials of the said allegation in Paragraph VII of plaintiff's complaint are true, and that the Court erred in holding them

untrue in Finding 10, and that, since this question was a material issue of fact in this case, the judgment herein is therefore against the law.

(d.) Paragraph III of the Answer of defendant Glens Falls Indemnity Company denies on lack of knowledge or information sufficient to form a belief, and Paragraph V of the Answer of defendant E. F. Grandy, Inc., denies specifically the allegation of Paragraph X of plaintiff's complaint that said defendants knew that V. L. Murphy had to obtain materials from plaintiff.

This point is fully covered in Point 4-a of this Motion for New Trial and the same errors specified there apply with equal force here. Therefore, it must be held that said defendants' denials of the said allegation in Paragraph X of plaintiff's complaint are true and that the Court erred in holding them untrue in Finding 10, and that since this allegation of such knowledge on the part of said defendants is a material issue of fact in this case, the judgment herein is against the law.

5. There is no finding establishing the corporate existence [132] and capacity of defendant E. F. Grandy, Inc., and therefore jurisdiction of the Court in this case is not shown by the findings of fact and Finding 3 is unsupported by a direct finding in this regard.

6. At the time of the trial, on May 8th, 1953, defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., specifically objected to the intro-

duction into evidence of plaintiff's exhibits for identification numbers 1, 9 and 10. The Court reserved a ruling on these objections. Said defendants pointed out this fact in their Trial Brief, filed subsequently. The Court however, never ruled on these objections.

7. The Findings of Fact and Conclusions of Law state that this case "was presented upon the complaint of the plaintiff, and the Answer filed on behalf of defendants Glens Falls Indemnity Company and E. F. Grandy, Inc." This statement is incomplete and should be corrected. It should state that this case was presented upon the complaint of the plaintiff and the respective answers filed on behalf of defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., and upon plaintiff's two respective Interrogatories and the respective responses thereto by defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., and upon plaintiff's Request for Admissions of defendant E. F. Grandy, Inc., and responses thereto by said defendant and upon the facts as agreed upon by counsel at the pre-trial conference held herein on April 1st, 1953.

Wherefore, Defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., move that they may be granted a new trial in said cause upon a date certain to be fixed by the Court and that the findings of fact and conclusions of law herein be amended in accordance with the specifications con-

tained herein, pursuant to Rules 52 and 59 of the Federal Rules of Civil Procedure. [133]

Dated: June 19th, 1953.

Respectfully submitted,

/s/ JOHN E. McCALL,

Attorney for Defendants, Glens Falls Indemnity Company and E. F. Grandy, Inc. [134]

Affidavit of Service by Mail attached. [137]

[Endorsed]: Filed June 19, 1953.

[Title of District Court and Cause.]

NOTICE OF MOTION FOR NEW TRIAL

To American Seating Company, a Corporation, and to its attorneys, Wolfson & Essey and Irving H. Green; and to the Farmers & Merchants Bank of Long Beach, a Corporation, and to its attorney, M. W. Horn:

You and Each of You Will Please Take Notice that on Monday, the 6th day of July, 1953, at 10:00 a.m., or as soon thereafter as counsel may be heard, in the above-entitled Court, located on the 2nd Floor of the Federal Building, Los Angeles, California, Defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., will move the Court for an order setting aside the judgment herein and granting a new trial to the Glens Falls Indemnity Company and [138] E. F. Grandy, Inc., and for such other order or orders as may be meet and just.

Dated: June 19th, 1953.

/s/ JOHN E. McCALL,
Attorney for Defendants, Glens Falls Indemnity Company and E. F. Grandy, Inc. [139]

Affidavit of Service by Mail attached. [140]
[Endorsed]: Filed June 19, 1953.

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: June 25, 1953. At Los Angeles, Calif.

Present: The Hon. Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: None.

Counsel for Plaintiff: No appearance.

Counsel for Defendants: No appearance.

Proceedings: On the Court's own motion It Is Ordered that defendants' motion for new trial is continued from July 6, 1953, to October 5, 1953, at 10 a.m.

It Is Further Ordered that if counsel desire attention to the motion earlier than October 5, 1953, they may fine memo. of points and authorities and a stipulation for submission of the motion on those points and authorities, or they may file briefs, provided they do not wish to have the motion argued orally.

Clerk will notify counsel.

EDMUND L. SMITH, Clerk
/s/ By WM. A. WHITE, Deputy Clerk [141]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: Sept. 30, 1953. At Los Angeles, Calif.

Present: The Hon. Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: None.

Counsel for Plaintiff: No appearance.

Counsel for Defendants: No appearance.

Proceedings: On the Court's own motion It Is Ordered that hearing on motion of defendants Glens Falls Indemnity Co. and E. F. Grandy Inc. is continued from October 5, 1953, to October 19, 1953, 11 a.m.

Clerk to notify counsel.

EDMUND L. SMITH,
Clerk
/s/ By WM. A. WHITE,
Deputy Clerk [142]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: October 19, 1953. At Los Angeles, Calif.

Present: The Hon. Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: Marie Zellner.

Counsel for Plaintiff: Irving H. Green.

Counsel for Defendant: Albert Lee Stephens, Jr.

Proceedings: For hearing on defendant's Glens Falls Indemnity Company and E. F. Grandy, Inc., motion for new trial.

Attorney for defendants argues motion for new trial.

Plaintiff replies to defendant's argument.

It Is Ordered either party may file further memorandas, if they so desire and will notify the clerk by letter on or before 10/21/53 of their intentions to do so, said memoranda to be filed by 5 p.m., October 26, 1953 when said motion will stand submitted.

EDMUND L. SMITH,
Clerk
/s/ By WM. A. WHITE,
Deputy Clerk [161]

[Title of District Court and Cause.]

MINUTES OF THE COURT

Date: Dec. 31, 1953. At Los Angeles, Calif.

Present: The Hon. Ernest A. Tolin, District Judge; Deputy Clerk: Wm. A. White; Reporter: None.

Counsel for Plaintiff: No appearance.

Counsel for Defendants: No appearance.

Proceedings: It Is Ordered that motion of defendants Glens Falls Indemnity Co. and E. F.

Grandy, Inc., for new trial, heretofore taken under submission, be, and hereby is denied.

Clerk will notify counsel.

EDMUND L. SMITH,
Clerk
/s/ By WM. A. WHITE,
Deputy Clerk [170]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Glens Falls Indemnity Company, a New York corporation, and E. F. Grandy, Inc., a California corporation, defendants above named, hereby appeal to the United States Court of Appeals for the Ninth Circuit, from the final judgment entered in this action on June 9, 1953, a motion for new trial by said defendants having been denied by order entered December 30, 1953.

Dated: January 26, 1954.

/s/ JOHN E. McCALL,
Attorney for Appellants Glens Falls Indemnity Company and E. F. Grandy, Inc. [177]

[Endorsed]: Filed January 26, 1954.

[Title of District Court and Cause.]

SUPERSEDEAS BOND

Know All Men By These Presents:

That E. F. Grandy, Inc., a California corporation, as Principal, and Great American Indemnity Company, a New York corporation, authorized to transact a surety business in the State of California, as Surety, are held and firmly bound unto American Seating Company, a New Jersey corporation, in the full and just sum of Ten Thousand Dollars ($10,000) to be paid to the said American Seating Company, its certain attorney, successors and assigns; to which payment well and truly to be made, we bind ourselves, jointly and severally, by these presents. [178]

Whereas, on June 9, 1953, in an action pending in the United States District Court for the Southern District of California, Central Division, between American Seating Company, as plaintiff, and Glens Falls Indemnity Company and E. F. Grandy, Inc., as defendants, a money judgment was rendered against said defendants and the said defendants having filed a Notice of Appeal from the said judgment to the United States Court of Appeals for the Ninth Circuit;

Now Therefore, the condition of this obligation is such that if E. F. Grandy, Inc. shall prosecute its appeal to effect and shall satisfy the judgment in full together with costs, interest and damages for delay if for any reason the appeal is dismissed or

if the judgment is affirmed, and shall satisfy in full such modification of the judgment and such costs, interest and damages as the Appellate Court may adjudge and award, then this obligation to be void; otherwise, to remain in full force and effect.

The above-named Surety, Great American Indemnity Company, hereby consents and agrees that in case of default or contumacy on the part of the Principal or said Surety, the Court may, upon notice to said Surety of not less than ten (10) days, proceed summarily and render judgment against it in accordance with its obligation and award execution thereon.

In Witness Whereof, the Principal has hereunto set its hand and seal by duly authorized officer thereof and Surety has caused this bond to be executed by its duly [179] authorized attorney in fact and caused its corporate seal to be hereunto affixed this 22nd day of January, 1954.

E. F. GRANDY, INC.,
/s/ By E. F. GRANDY, Pres.
Principal

[Seal] GREAT AMERICAN INDEMNITY COMPANY,

/s/ By HAROLD W. McGEE,
Attorney in Fact—Surety

Executed in duplicate.

The Premium on this bond is $200.00 per annum.

Examined and recommended for approval as provided in United States District Court for the

Southern District of California, Central Division, Local Rule No. 8.

/s/ JOHN E. McCALL,
Attorney for Defendants Glens Falls Indemnity Company and E. F. Grandy, Inc.

Duly Verified.

I hereby approve the foregoing.

Dated this 26th day of January, 1954.

/s/ ERNEST A. TOLIN, Judge [180]

[Endorsed]: Filed January 26, 1954.

[Title of District Court and Cause.]

SUPERSEDEAS BOND

Know All Men By These Presents:

That Glens Falls Indemnity Company, a New York corporation, and Great American Indemnity Company, a New York corporation, authorized to transact a surety business in the State of California, as Surety, are held and firmly bound unto American Seating Company, a New Jersey corporation, in the full and just sum of Ten Thousand Dollars ($10,000) to be paid to the said American Seating Company, its certain attorney, successors and assigns; to which payment well and truly to be made, we bind ourselves, jointly and severally, by these presents. [181]

Whereas, on June 9, 1953, in an action pending

in the United States District Court for the Southern District of California, Central Division, between American Seating Company, as plaintiff, and Glens Falls Indemnity Company and E. F. Grandy, Inc., as defendants, a money judgment was rendered against said defendants and the said defendants having filed a Notice of Appeal from the said judgment to the United States Court of Appeals for the Ninth Circuit;

Now Therefore, the condition of this obligation is such that if Glens Falls Indemnity Company shall prosecute its appeal to effect and shall satisfy the judgment in full together with costs, interest and damages for delay if for any reason the appeal is dismissed or if the judgment is affirmed, and shall satisfy in full such modification of the judgment and such costs, interest and damages as the Appellate Court may adjudge and award, then this obligation to be void; otherwise, to remain in full force and effect.

The above-named Surety, Great American Indemnity Company, hereby consents and agrees that in case of default or contumacy on the part of the Principal or said Surety, the Court may, upon notice to said Surety of not less than ten (10) days, proceed summarily and render judgment against it in accordance with its obligation and award execution thereon.

In Witness Whereof, the Principal has hereunto set its hand and seal by duly authorized officer thereof and Surety has caused this bond to be ex-

ecuted by its duly [182] authorized attorney in fact and caused its corporate seal to be hereunto affixed this 22nd day of January, 1954.

GLENS FALLS INDEMNITY COMPANY,

/s/ By JOHN E. McCALL, Attorney, Principal

[Seal] GREAT AMERICAN INDEMNITY COMPANY,

/s/ By HAROLD W. McGEE, Attorney in Fact—Surety

Executed in duplicate.

The Premium on this bond is $200.00 per annum.

Examined and recommended for approval as provided in United States District Court for the Southern District of California, Central Division, Local Rule No. 8.

/s/ JOHN E. McCALL,

Attorney for Defendants Glens Falls Indemnity Company and E. F. Grandy, Inc.

Duly Verified.

I hereby approve the foregoing.

Dated this 26th day of January, 1954.

/s/ ERNEST A. TOLIN, Judge [183]

[Endorsed]: Filed January 26, 1954.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the United States District Court for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 194, inclusive, contain the original Complaint; Summons; Stipulation; Answer to Complaint; Plaintiff's Interrogatories to Defendant Glens Falls Indemnity Company; Answer to Interrogatories; Notice of Trial Setting; First Alias Summons; Answer of Defendant E. F. Grandy, Inc.; Request for Admissions; Plaintiff's Interrogatories to Defendant E. F. Grandy, Inc.; Substitution of Attorneys; Answer to Interrogatories; Answer to Request for Admissions; Plaintiff's Memorandum Brief; Memorandum Brief of Defendant Farmers and Merchants Bank of Long Beach; Pre-Trial Brief of Glens Falls Indemnity Company et al; Reply Brief of Plaintiff; Memorandum re Time of Trial; Pre-Trial Brief of Glens Falls Indemnity Company et al; Plaintiff's Reply to Defendants' Brief; Findings of Fact and Conclusions of Law; Judgment; Cost Bill; Motion for New Trial; Notice of Motion for New Trial; Defendants' Supplemental Memorandum on Motion for New Trial; Points and Authorities of Plaintiff; Reply to Points and Authorities of Plaintiff; Ex Parte Motion for Ten-Day Stay of Execution; Ex Parte Motion and Order for Stay of Execution; Notice of Appeal; Two Supersedeas Bonds; Designation of Record on Appeal; Designation of Additional

Portions of Record on Appeal; and Appellee's Objection to Designation of Non-Essential Matter by Appellants and a full, true and correct copy of Minutes of the Court for October 6, 1952, January 5, February 3, April 1, May 8 and 27, June 25, September 30, October 19 and December 13, 1953 which, together with original Plaintiff's Exhibits 1 to 17, inclusive, and Defendants' Exhibits A, B, and C, and Reporter's Transcript of Proceedings on April 1 and May 8, 1953, in two volumes, transmitted herewith, constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing and certifying the foregoing record amount to $6.40 which sum has been paid to me by appellants.

Witness my hand and the seal of said District Court this 2nd day of March, A.D. 1954.

[Seal] EDMUND L. SMITH,
Clerk.
/s/ By THEODORE HOCKE,
Chief Deputy.

In the United States District Court, Southern District of California, Central Division

No. 14,305-T Civ.

AMERICAN SEATING COMPANY,

Plaintiff.

vs.

GLENS FALLS INDEMNITY COMPANY, E. F. GRANDY, INC., FARMERS AND MERCHANTS BANK OF LONG BEACH,

Defendants.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

Los Angeles, California.

Wednesday, April 1, 1953.

Honorable Ernest A. Tolin, Judge Presiding.

Appearances: For Plaintiff: Irving H. Green, Esq. For Defendants: John E. McCall, Esq., and George Sturr, Esq., for defendants Glens Falls and E. F. Grandy. M. W. Horn, Esq., for defendant Farmers & Merchants Bank of Long Beach. [1*]

The Court: Mr. Reporter, we commenced an informal pretrial in the absence of the official reporter, in our customary way, having the intention to dictate a summary of it.

However, it appears that there is possibly more in this case than the Court can adequately sum-

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* Page numbering appearing at top of original Reporter's Transcript of Record.

marize without some record being made as we go along, and some dispute has arisen.

It was understood at the outset that the facts of the case would be conceded. Mr. Green has undertaken to state the facts of the case, and Mr. McCall has taken issue with a part of that statement.

We therefore decided to place the remainder of the pretrial on record, and when I say "remainder," we will *state* fresh with a statement of facts.

The dispute has arisen over a letter, of which a photostat has been marked Plaintiff's Exhibit 1 for identification in our record.

We will allow that to stand, noting that it is for identification, and it is not received in evidence.

Mr. McCall has said that Mr. Green's statement of facts in this pretrial statement is accurate, provided it be shorn of the conclusions. When we get to determining what [2] is a conclusion and what is an allegation of fact, we often have difficulty.

So, Mr. McCall, will you state again, or Mr. Green, and if any other counsel disagrees with any part of the statement, just put in your comment; but if we can now get what are admitted facts, that will be very helpful.

Mr. McCall: I notice that this letter, which I believe your Honor stated would be marked for identification, does not appear to have been signed.

Mr. Green: This is a photostat copy of the copy that was in the Grandy file when it was turned over to us, and that original copy was returned to Grandy, and if Mr. McCall has the file, he will find that in the file. This is not the original letter.

This is not a photostat of the original letter that was received by Mr. Murphy.

The Court: You are contending this is the writer's file copy of the letter which he sent?

Mr. Green: Yes.

The Court: Are you contending the letter was signed by someone when it was sent?

Mr. Green: The file copy wouldn't be signed, naturally, but the original was signed.

The Court: Who signed the original?

Mr. McCall: I never heard of it before, and it doesn't appear to be signed by anyone. [3]

The Court: The file copy ordinarily isn't.

Mr. McCall: I don't have his file, but he has been telling me for a long time that he didn't have all the file back from the attorneys when they sued Mr. Murphy.

Mr. Green: We will take Mr. Grandy's deposition, and at all times Mr. McCall has said they would agree to the facts, but he won't do it.

Mr. McCall: I want to nab that right away. There was never impression given there was any liability. If he wants to take Grandy's deposition, I suggest we let him take Grandy's deposition, and then let us have the pretrial.

The Court: Let us conclude this as a pretrial hearing, and then we can resume it after the taking of the deposition, if it is indicated.

I would not like to lose the benefit of having all of you gentlemen here today. We might develop further the controversy which will shape the depo-

sition into one particular area which you feel you are in agreement on.

Mr. Green: Mr. McCall made the statement before this court in this hearing that he stipulated that in the plaintiff's memorandum brief on this pretrial, filed with this court, that the statement of essential facts as set out in that memorandum brief is true and correct. [4]

Is that true or is that not true, Mr. McCall?

Mr. McCall: I don't think that is repeating just what I said. My recollection right now is that——

Mr. Green: Regardless of what you said, what do you say now, Mr. McCall?

Mr. McCall: I haven't seen the statement for some time, but I believe it contains a true statements of facts when it is divested of all of the conclusions in it.

The Court: The difficulty is to tell what are conclusions, and when you say "essential facts," you might not consider as essential some fact which Mr. Green does.

Mr. McCall: I would be glad to take his statement of facts, and we will read it to the Court right now.

The Court: Mr. Green can read it now, but let us take what the essential facts of the case are.

We want the facts and not the conclusions, so that I can, in doing my book work and study of this case, treat of those matters as admitted facts.

So, if you cannot admit them, say so. If you can admit them, say so. We want the ultimate facts,

or you can detail it down to the evidentiary facts, if you feel so advised.

I think it is better if you give me a synopsis of the evidentiary facts.

Mr. McCall: If we think he is making conclusions [5] and self-serving statements, shall we object right there?

The Court: Object, but don't get into a quarrel about it. You say what you think.

Mr. Green: Sometime in April, 1949, the defendant E. F. Grandy, Inc., a corporation, entered into a written contract with the United States Government.

Grandy, as general contractor, made this contract for the performance of certain work at the United States Naval Ammunition and Net Depot at Seal Beach, California.

On the 4th day of May, 1949, Grandy, as general contractor, entered into a written subcontract with one V. L. Murphy, a plumbing contractor.

Do you have that original contract so that we can have it marked and put in evidence, and there won't be any dispute about it?

Mr. Sturr: You mean the subcontract?

Mr. Green: Yes, the subcontract.

Mr. McCall: Here it is.

Mr. Green: May we offer that to be marked in evidence?

Mr. McCall: It can be made a defendant's exhibit.

Mr. Green: We can make it a plaintiff's exhibit.

The Court: We can make it a plaintiff's exhibit for identification. [6]

Mr. McCall: I can have mine back then.

The Court: Yes. It will be marked Plaintiff's Exhibit 2 for identification.

(The document was thereupon marked Plaintiff's Exhibit 2 for identification.)

Mr. Green: Do you agree, counsel, that that is the contract?

Mr. McCall: Yes, that is the subcontract.

Mr. Green: All right, the subcontract.

Mr. McCall: Between Grandy and Murphy.

Mr. Green: This contract, to summarize it for the facts, provided that Murphy was to furnish all materials, labor, tools, and so forth——

Mr. McCall: That is just what I——

Mr. Green: Let me finish, please.

Mr. McCall: When the Court said when something came out that way, we were to object, and so I am objecting. The contract speaks for itself, and counsel is trying to say what the contract provides.

Mr. Green: That is for the benefit of the Court.

The Court: We will consider it said parenthetically.

Mr. Green: Parenthetically, then, we will say the contract provides that Murphy was to furnish all materials, labor, tools, and so forth, and to perform and complete the plumbing and pipe portion of the work. [7]

The contract price on the subcontract was the sum of $16,667.05.

For the record, Murphy and Grandy agreed, and

when I speak of Grandy I am talking about the corporation, that Murphy would furnish a performance bond in the sum of $16,667.05, and a payment bond in the principal sum of one-half, or $8833.58.

The Court: By payment bond do you mean a bond which will insure the payment of all material men?

Mr. Green: The bond speaks for itself too, your Honor, and if you will give me your photostat copies—well, I have them.

Pursuant to that agreement between Grandy and Murphy, Murphy furnished to Grandy a performance bond issued by the Glens Falls Indemnity Company of New York on the 18th day of May, 1949, and we offer that to be marked as Plaintiff's Exhibit 3 for identification.

Mr. McCall: No objection.

The Court: It may be marked Plaintiff's Exhibit 3 for identification.

(The document was thereupon marked Plaintiff's Exhibit 3 for identification.)

Mr. Green: For the record, Mr. McCall, you agree and admit that is a photostat copy of the performance bond written by your company? [8]

Mr. McCall: That is right.

Mr. Green: All right. On the same date he also furnished a payment bond, dated May 18, 1949. We would like to have that marked for identification as Plaintiff's Exhibit No. 4.

Mr. McCall: What is No. 1?

The Court: The letter is Plaintiff's Exhibit 1

for identification. The sequence is not quite right, you understand.

Mr. Green: I understand that.

Mr. McCall: Yes.

The Court: The letter is Plaintiff's Exhibit No. 1.

The contract is Plaintiff's Exhibit No. 2.

The performance bond is Plaintiff's Exhibit No. 3.

And the payment bond is Plaintiff's Exhibit No. 4.

(The document was thereupon marked Plaintiff's Exhibit 4 for identification.)

The Court: All these exhibits are marked for identification only.

Up to date is there any question as to the genuineness of any of these instruments, and may the Court consider the photostats in lieu of the originals?

Mr. McCall: Except as to the letter, so far as we are concerned.

The Court: As to the other three, is it stipulated [9] these photostats are true copies and that they were duly issued on or about the date they bear?

Mr. McCall: Yes. Could I compare those with mine?

Mr. Green: For your information, Mr. McCall, you furnished us those photostat copies. So, if they are in error, the error is yours, not ours.

Mr. McCall: You mean the photostat copy?

The Court: In the absence of something being pointed out, we will assume they photostated the right things.

Mr. Green: Parenthetically, again, the perform-

ance bond provides that Murphy shall carry out all the conditions and agreements of his subcontract; otherwise the penalty of the bond applies.

The payment bond provides——

Mr. McCall: That is not in evidence yet.

The Court: None of these are in evidence. They are marked for identification.

Of course, the several stipulations entered into between counsel will be the proper foundation for someone moving their admission in evidence at the proper time.

Mr. McCall: This is Plaintiff's Exhibit No. 4 for identification?

The Court: Yes.

Mr. Green: The payment bond provides, and I am now [10] quoting so I don't have to make this parenthetically:

"Now, therefore, if the above principal shall indemnify and hold the said Obligee free and harmless from and against all loss and damage by reason of its failure to promptly pay to all persons supplying labor and materials used in the prosecution of the work provided for in said subcontract, then this obligation to be null and void, otherwise to remain in full force and effect."

I believe that answers the court's question as to the provisions of the payment bond.

The Court: When I was in law school a long time ago, that is what they called the bond against liens.

Mr. Sturr: That is going to be one of our questions as to the legal interpretation.

Mr. Green: Are you challenging whether this is a payment bond or not?

Mr. Sturr: It is a payment bond by its term and title.

Mr. Green: Payment of what?

Mr. McCall: The bond speaks for itself.

The Court: Let's get on with the facts.

Mr. Green: As part of said subcontract, it was necessary for V. L. Murphy to obtain from the [11] plaintiff certain material and equipment, which are described as a chemical sink, a chemical table, and a chemical fume hood. These were furnished by American Seating Company at the agreed price of $6124.37, were installed in connection with the subcontract for plumbing into the project, for which E. F. Grandy, Inc., had the principal contract.

The entire contract was accepted by the Government and E. F. Grandy was paid in full by the Government on this contract.

E. F. Grandy knew that it was necessary to obtain this material from——

Mr. McCall: There, of course, we object again as to what E. F. Grandy knew. That obviously is a conclusion.

Mr. Green: We are going to have exhibits marked to show it, your Honor.

The Court: All right.

Mr. Green: So we don't have to rely on counsel's argument.

Mr. McCall: May I ask counsel if he has returned to E. F. Grandy or to Grandy, Inc., all the originals of these which he has photostat copies of?

Mr. Green: Are they returned? You have the Grandy file.

Mr. McCall: That doesn't answer the question.

Mr. Green: They were all returned to him.

Mr. McCall: So he is supposed to have all the originals of all the photostats you have now?

Mr. Green: You mean you came here without first seeing your client's files as to what the facts are?

Mr. McCall: You haven't even returned his checks to him, so how can I see them?

Mr. Green: I am not talking about the checks. You know what I am talking about.

In view of Mr. McCall's position, I would like to join with him in the situation of having this pretrial continued, and we will take Mr. Grandy's deposition and we will have the facts that we can establish by his examination and not have counsel harping and challenging written documents and facts.

Mr. McCall: I don't think my objection was offensive. I certainly didn't intend it to be. The court is the best judge of that.

The Court: No one has offended the court here, and I am learning somewhat what the issues are, and learning what might be issues and what might be dissipated by continuing exactly as we are here today.

Bear in mind, we are not trying the case today, and no one need make any speeches asserting the validity of a position he takes either for or against

the plaintiff, [13] but we want to find out what these facts are and which facts are disputed.

So let's go forward, and you can take the deposition and do probably a much better job in the light of your experience gained here today.

But let us have that experience first so you will have the benefit of it, if there is any.

Mr. Green: Under date of August 22, 1949, a quotation was issued by the American Seating Company to all contractors in re this particular job, setting out the quotation for these particular items that were eventually incorporated into the project, and this was received, a copy of this was received by E. F. Grandy, Inc., on September 24, 1949; and I would like to offer that.

Mr. McCall: It is not necessary to object?

The Court: It is not necessary to object. We are just getting these documents marked for identification.

Mr. Green: The only reason I am having these marked for identification at this time is to have counsel either admit their validity or dispute their validity.

The Court: After you get them all marked, I will go through them seriatim and get an admission or rejection.

Mr. McCall: Can I see that, please?

Mr. Green: I will have it marked, and then I will be [14] glad to show it to you.

The Court: It will be marked Plaintiff's Exhibit 5 for identification.

(The document was thereupon marked Plaintiff's Exhibit 5 for identification.)

Mr. Green: That, your Honor, is the quotation, marked Plaintiff's Exhibit 5 for identification, and has on it the receipt stamp of the E. F. Grandy Company, and that is a photostat copy, and we want counsel to either admit or deny its validity.

Mr. McCall: It bears date August 22, 1949. Would counsel state the purpose of this? I don't see that it has any bearing here at all.

The Court: We will get to that phase of this proceeding a little later. At present, is the genuineness of this document admitted, the fact that it was dispatched as would prima facie appear on its face? Whether it is relevant or not, I don't know.

Mr. McCall: There is nothing admitted about it. It is something that isn't even addressed to Grandy, Inc. It is signed "American Seating Company, by T. E. Dewey."

Mr. Green: Do you admit that it bears the receipt stamp of E. F. Grandy, Inc., September 24, 1949?

Mr. McCall: It bears the stamp, but I don't know if it is the receipt stamp of the Grandy Company. [15]

Mr. Green: We are not getting any place. If counsel won't admit black is black and white is white, we might as well try the case in court and produce our witnesses.

The Court: We are getting these into the record now, marking them for identification. I will require,

however, prior to trial, that these be either admitted or denied.

For the present, they need not be, but if we can eliminate the question of validity as to any one, we should do it. If he is not in a position to do it, we won't force him. He is entitled to consult his client.

Mr. Green: Those things are in for identification and they are in the file that was furnished.

Mr. McCall: That is self-serving and untrue. We did not come into court this morning with anything that we haven't already furnished to plaintiff's counsel so he will know just what we are here with.

The Court: I am not going to try either the efficiency or the inefficiency of any counsel, and I think it will be better for your respective healths if you will avoid taking umbrage with one another.

Mr. McCall: I have low blood pressure anyway, and I am not saying anything to be offensive.

If it would suit the court better, he could bring in whatever he pleases, with the understanding that all objections are reserved for later. [16]

Mr. Green: I won't put in figures in a pretrial so you could have a chance to figure out ways to defeat them.

The Court: That is his privilege.

This is marked Plaintiff's Exhibit 5 for identification.

I know we are just trying to get facts now, but what is your contention that this letter does show, parenthetically for the moment?

Mr. Green: On August 23, 1949, the American Seating Company wrote a letter to V. L. Murphy Plumbing Company concerning this matter, and a copy was sent to E. F. Grandy, Inc., and was received by E. F. Grandy, Inc. on August 25, 1949.

May we have that marked as Plaintiff's Exhibit No. 6?

I ask counsel to either admit or deny they received that.

Mr. McCall: This appears to be a letter addressed to Mr. Murphy, signed by Mr. John D. Mullen, a copy of which was sent to Grandy and stamped "Received August 25, 1949, E. F. Grandy, Inc."

I assume it is genuine.

The Court: Are you willing to admit it is genuine, namely that, it was transmitted as it purports to be, and received by the addressee, or do you want to reserve [17] that?

Mr. McCall: I would like to reserve that and talk to Grandy.

The Court: We will consider that one reserved.

(The document was thereupon marked Plaintiff's Exhibit 6 for identification.)

Mr. Green: Will you mark this for identification?

The Court: That will be Plaintiff's Exhibit 7 for identification.

(The document was thereupon marked Plaintiff's Exhibit 7 for identification.)

Mr. Green: Under date of September 23, 1949, a purchase order was sent to American Seating Com-

pany by V. L. Murphy. A copy of it was sent to E. F. Grandy and received by them on September 24, 1949, a photostat of that, with the stamp of the Grandy Company, which has been marked for identification as Plaintiff's Exhibit No. 7.

Under date of September 26, 1949, E. F. Grandy forwarded to the officer in charge of construction, U.S. Naval Base, Los Angeles, at Long Beach, California, concerning this contract, the following letter:

Enclosed herewith four (4) copies Purchase Order from V. L. Murphy, plumbing subcontractor, to American Seating Company, agents for Kewaunee Manufacturing Company for chemical laboratory [18] equipment presenting being manufactured at Adrian, Michigan.

"It is requested that the Officer-in-Charge of Construction do everything possible to expedite factory inspection in order that, immediately upon completion, this equipment may be forwarded for installation."

That was sent by E. F. Grandy, Inc., a photostat copy of the file copy, which I have here and ask be marked Plaintiff's Exhibit No. 8.

The Court: It may be marked Plaintiff's Exhibit No. 8 for identification.

(The document was thereupon marked Plaintiff's Exhibit 8 for identificaton.)

Mr. Green: Under date of December 20, 1949, the American Seating Company wrote a letter to E. F. Grandy, Inc.——

Mr. McCall: What is the date, please?

Mr. Green: December 20, 1949—concerning this contract, and I offer that to be marked as Plaintiff's Exhibit No. 9.

The Court: It may be marked Plaintiff's Exhibit No. 9 for identification.

(The document was thereupon marked Plaintiff's Exhibit 9 for identification.) [19]

Mr. Green: That is a photostat copy of the original letter that was in the E. F. Grandy Company file.

Under date of December 22, 1949, E. F. Grandy wrote to the Officer-in-Charge of Construction relative to these, and enclosed three copies of correspondence received from American Seating Company relative to this matter, and the photostat copy of the file copy of that letter I ask be marked Plaintiff's Exhibit No. 10.

The Court: It may be marked Plaintiff's Exhibit No. 10 for identification.

(The document was thereupon marked Plaintiff's Exhibit 10 for identification.)

Mr. Green: Under date of January 6, 1950, E. F. Grandy wrote a letter to the American Seating Company. This is a photostat copy of the file copy, and I offer that as Plaintiff's Exhibit 11 for identification.

The Court: It may be marked Plaintiff's Exhibit No. 11 for identification.

(The document was thereupon marked Plaintiff's Exhibit No. 11 for identification.)

Mr. Green: It is a letter to American Seating Company concerning this particular subcontract.

These documents all have been marked Plaintiff's exhibits for identification, I assume, as part of this pretrial record, concerning which counsel will admit or [20] deny the genuineness.

Mr. McCall: They have never been submitted to counsel.

The Court: They are all exhibits marked for identification in this proceeding, and counsel may, of course, examine them.

Mr. Green: Going on with the facts, American Seating Company did furnish this material, it was installed, and was approved by the Government and accepted by the Government, and E. F. Grandy Company was paid in full by the Government for the job. They did not pay American Seating Company and V. L. Murphy did not pay American Seating Company, and to this day American Seating Company hasn't been paid.

The Court: Then the bank gets in? This is a parenthetical statement.

Mr. Green: If the court will bear with me a few moments, I will bring that out.

The Court: All right.

Mr. Green: American Seating Company, when they realized that Murphy wasn't going to pay, then took up the matter with Murphy. Murphy claimed he hadn't been paid by Grandy yet.

Mr. McCall: Will you give the dates for that?

Mr. Green: The exact dates I don't think are material [21] until we come to the dates that are material.

Thereupon American Seating Company contacted

Mr. Grandy and found out Murphy had been paid, and on December 1, 1950, wrote a letter to the Glens Falls Indemnity Company, in which it made demand for payment under the payment bond that had been filed.

Mr. McCall: That was December 1, 1950?

Mr. Green: That was December 1, 1950. And attached a copy of the sales invoice for the material, and sent it by registered mail, and was receipted for by Glens Falls Indemnity, by B. McGee.

A copy of the letter was also sent to E. F. Grandy, Inc., and to Eva L. Cole, Cole Insurance Company, and a copy to Miss Ruth Casalini of the San Francisco office.

We offer this to be marked as Plaintiff's Exhibit 12 for identification.

Mr. Sturr: Just as a query, whose San Francisco office? San Francisco office of what?

Mr. Green: I don't know.

The Court: Do you want to answer that, Mr. Green?

Mr. Green: I said I don't know, your Honor. It just says "San Francisco Office" on the bottom. I don't think it is material. That might be the San Francisco office of the American Seating Company.

The Court: Plaintiff's Exhibit 12 for identification. [22]

(The document was thereupon marked Plaintiff's Exhibit No. 12 for identification.)

Mr. Green: Under date of January 3, 1951, Glens Falls Indemnity Company wrote a letter to the American Seating Company, which I will ask be

marked Plaintiff's Exhibit 13 for identification. In this letter—well, the letter speaks for itself.

(The document was thereupon marked Plaintiff's Exhibit No. 13 for identification.)

Mr. Green: One further statement of fact was that sometime around December 1, 1950—I don't have the exact date, but I don't think the exact date is material—the American Seating Company called Glens Falls Indemnity Company about this matter, and were told by them that before they could collect on the bond, they would have to sue Murphy and get a judgment against him.

Mr. McCall: I would like to object to that going into this record.

The Court: You dispute that?

Mr. McCall: I dispute that strongly.

Mr. Green: We know he disputes it.

The Court: We want to just smoke out the dispute. Now we have a disputed fact.

Mr. Green: I don't think that is a material matter, substantially. [23]

The Court: You can determine whether it has sufficient materiality to lay a foundation for it and establish it as against a dispute, or not.

Mr. Green: And they were told by the Glens Falls Indemnity Company that they should first get a judgment against Murphy and they would proceed against Murphy, but the judgment has never been collected, and, so far as I know, Murphy is insolvent and it is uncollectible.

Mr. McCall: Your Honor, before he goes to something else, would the court please require counsel

to state who called and who answered? He says the plaintiff called the company. That doesn't mean anything. Who did they call and who did they talk to? We have no knowledge for meeting the issue if he just says the plaintiff called the company.

Mr. Green: We don't have to give counsel issues to meet now. We claim what the facts are now, and if he disputes that, let him take care of it by interrogatories or deposition, if he wants to find out.

The Court: Customarily, counsel urging a fact of this kind will, in a pretrial, divulge it. If you do not wish to divulge it, you do not have to.

However, it is his privilege to reach it by interrogatories, which the court would require be answered, what the evidence is, who called, who talked to whom, and so on. [24]

Mr. Green: The only reason I am not stating it right off is that I don't have the fact right at hand. I can find it.

The Court: If you can find it, let him know. I don't mean to prejudge this, but just offhand I don't think it makes any difference.

Mr. Green: I don't think so, either.

(At request of counsel for the respective parties, discussion between the court and counsel concerning the status of the Farmers & Merchants Bank of Long Beach, which ensued at this point in the proceedings, is omitted from the transcript.)

Mr. Green: I have the checks paid by E. F. Grandy to V. L. Murphy and the Farmers & Merchants Bank. They can be marked for identification.

Mr. McCall: I would like to object to those even being marked for identification until they are returned to Mr. Grandy so that he can get the photostat copies of them. Those are the checks Grandy tells me he has been after plaintiff's counsel to return to him for many months, and they refused to return them.

Mr. Green: That is not true. He never asked.

The Court: You can get photostat copies here. The clerk's office provides photostat copies of anything in our file, exhibits or otherwise, at rates that I think are a [25] little below the usual commercial rates.

I think these things should be in our records, but if you would rather take them to your own photostat facility, we will ask Mr. Green if he has objection to letting them out for that purpose. Do they come from your file?

Mr. McCall: They were in the file that they got from my client, Mr. Grandy, and never returned all the file to him yet.

I have no objection to them going in here for identification, and I will get my photostat copies for Mr. Grandy. He has been needing those for some time, and I shall take it that the photostat copies will do just as well.

The Court: That photostating facility is available, Mr. Clerk, is it not, for exhibits?

The Clerk: Yes, your Honor.

The Court: Then give them exhibit numbers for identification.

Mr. McCall: Will they all be numbered together?

The Court: Let us number them as one exhibit.

Mr. McCall: How many are there, Mr. Clerk?

The Clerk: Six.

Mr. Green: Maybe I can save time if you want to stipulate and then you can have the checks back right now.

The facts show the following payments were made by [26] E. F. Grandy, Inc. to V. L. Murphy and the Farmers and Merchants Bank in connection with this subcontract:

July 8, 1949, $3182.40.

August 22, 1949, $4369.50.

October 25, 1949, $2152.72.

January 5, 1950, $3715.71.

February 1, 1950, $2166.74.

July 17, 1950, $1421.37.

Do both counsel agree?

Mr. Horn: I couldn't follow that fast.

Mr. Green: Well, I read the checks correctly.

Mr. Horn: I know you read them correctly, but I couldn't follow you that fast.

Mr. McCall: On behalf of defendant E. F. Grandy and defendant Glens Falls Indemnity Company, I will stipulate these checks are the originals, and that they were paid to V. L. Murphy Plumbing Company and Farmers and Merchants Bank according as shown on the face thereof.

Mr. Horn: I don't recognize the name J. L. Leonard, but we can enter into the same stipulation.

Mr. Green: May the record show I have turned over to Mr. McCall those checks?

The Court: You are surrendering them?

Mr. Green: I am surrendering them to him.

The Court: The checks are deemed surrendered to Mr. [27] McCall by Mr. Green.

As I understand it, all parties have entered into a stipulation that the amounts of money that the payee and payor, that Mr. Green has immediately stated in the stipulation, is conceded by everyone and deemed a stipulation, and may be considered such at the trial of this action?

Mr. Green: Yes.

Mr. McCall: Yes.

Mr. Horn: Yes.

Mr. Green: Incidentally, I have found in my file a memorandum as to who in the Glens Falls Indemnity Company talked to our man about the getting of the judgment; just to advise counsel, it was Mr. Sampson in the Claims Department.

Mr. McCall: Do you have the date of that, Mr. Green?

Mr. Green: No, I don't. I just have the memorandum of the conversation.

Mr. McCall: Who was it that talked to him?

Mr. Green: I don't know that either.

Mr. McCall: You just have a memorandum?

Mr. Green: I just have have a memorandum that such conversation took place, and I don't know who did it. I believe, your Honor, without limiting myself to things that may occur to me, that those are substantially the material facts in this case.

If there is any dispute about them or any addi-

tions [28] to them, I would like to hear from counsel.

Mr. Horn: Are you going to put the letters in?

Mr. Green: I have put in the gist of them.

Mr. Horn: All right.

The Court: Do you mind stating your legal theory as to the bank? I don't quite get how they tie in with a legal responsibility to your client.

(Further discussion in regard to status and position of the Farmers & Merchants Bank omitted at request of counsel.)

Mr. Green: Now I would like to ask Mr. McCall a question.

Do you have any other facts to add to the statement of facts we have agreed to?

Mr. McCall: Yes, I do.

Mr. Green: May I hear what they are?

The Court: Yes; I was going to ask Mr. McCall, what is the defense contention? What facts are there in the defense that are not apparent in the plaintiff's facts?

Mr. McCall: Since it is understood that none of the exhibits that have been put in here for identification, with the exception of those which we admitted, to wit, the exhibit, the subcontract, the payment bond, and the performance bond, we admit those and have no objection to them going into evidence. All the other things, the [29] photostat copies and so forth that counsel put in, of course, we haven't seen them and we don't admit anything.

The Court: You state now you are not in a posi-

tion to admit either the genuineness of the documents or the fact of delivery?

Mr. McCall: That is right; or if it is relevant. That will be for the court to decide.

The Court: We will have to decide relevancy at the trial. These other things should be decided before the trial. So, if you are going to deny the due execution, validity of the copy, and delivery of the document, Mr. Green can be prepared with his foundation proof at the time of trial. Otherwise where we can eliminate foundations at pretrial, we should.

There has been some indication of a desire to take further depositions. We should probably pretrial this again afer you have had that experience.

Mr. Green: Yes; but, counsel, I want to know what you admit and don't admit, so I can know on deposition what I have to go into. Before doing that, counsel should answer the court's question as to what defense he has to this case, if any.

The Court: I understand counsel is going to admit the genuineness of the documents and delivery as to some, and as to others he feels he should confer with his client before [30] doing so.

Mr. McCall: I admit the genuineness of the subcontract and the two bonds that have been produced here. I might say I have received from Mr. Grandy, and in my rush to get away from my office I left it on my desk, the duplicate original of the contract between Grandy, Inc., and the Federal Government, and which includes the performance bond and the labor and material, both. I think

they will be material later on, so I would like, if the court please, and I am sorry I didn't bring it with me, but I do have this in my office, but I just got it this morning.

Mr. Green: If you will stick to one thing, Mr. McCall, so we can get this in an orderly fashion, I will appreciate it and the court will appreciate it.

The court asked you a question as to which of these exhibits which have been admitted for identication you admit are genuine and which you claim are not, or which you claim you don't know and you will notify us later.

The Court: The term "genuine" includes delivery, doesn't it?

Mr. Green: Yes.

The Court: Can you tell us about any other than the bonds, which you have admitted?

Mr. McCall: I see a letter here for the first time. I am trying to read it a little bit. He has asked me as to [31] genuineness.

The Court: Take your time.

Mr. McCall: Thank you.

Did you put in, counsel, a photostat copy of this letter yet?

The Court: Are you referring to Exhibit 13?

Mr. McCall: No, this isn't even in for identification.

Mr. Green: It is marked for identification, if you will look on the other side.

Mr. McCall: That is genuine. What number is that?

Mr. Green: 13.

Mr. McCall: 13?

Mr. Green: Yes.

Mr. McCall: This one here, entered as Plaintiff's Exhibit 12, I would say that is genuine.

Mr. Green: All right.

Mr. McCall: It is entirely possible all these others here represent letters or documents that were written and received as they purport on their face. I just don't know. I will go over them with Mr. Grandy. I will get him to come up here.

The Court: After you get him to come up here, will you notify all counsel in the case and the court?

Mr. McCall: Yes; as to which ones.

The Court: As to which ones are. [32]

Mr. McCall: Yes.

The Court: I think that is probably better than having a meeting here just to do that.

Mr. McCall: Yes; why, certainly. I am quite sure they are what they purport to be.

I would like to ask counsel if he has the originals of those.

Mr. Green: No; they are all in Grandy's file that were returned to Grandy. If you have the file with you, if you will look in it, you will find the originals.

Mr. McCall: I don't have Grandy's file, but he will bring it to me. At the time I talked to Mr. Grandy, he was in the office with his files, but he didn't have much of his file then.

I have a statement of facts, your Honor.

The Court: Go ahead and make it.

Mr. McCall: On March 5, 1953, we filed on be-

half of Glens Falls Indemnity Company, defendant, and E. F. Grandy, Inc., a defendant, a document in this case marked Pretrial Brief of Defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., which has a purported statement of facts beginning on line 23 and ending on line 22 on page 2.

The Court: No; it begins on line 22 on page 1.

Mr. McCall: Yes; page 1.

The Court: And ends on line 22, on page 2. [33]

Mr. McCall: Yes; and ends on line 22, on page 2.

The Court: Yes.

Mr. McCall: Which is our statement of facts, with the exception of line 6 and that part of line 5 beginning after the word "surety," to the word "to." That is a conclusion and should be stricken from the facts now.

That reads: "to protect E. F. Grandy, Inc. in the event it suffers a loss by reason of the subcontract"——

The Court: You just mixed a little of your argument there.

Mr. McCall: That is right. So, for the statement of facts, that should go out, because it is a conclusion. But all the balance of that we claim is a statement of facts.

Since that is in the record, it is not necessary to read it into the record, I assume.

The Court: No. We will take it from here.

However, if you have anything further or want to elaborate on the details of this, you may, if you want to. You don't have to.

I notice that all statements of fact which have been given here this morning, and I mean by that your written statements as well, do not make any issue of whether or not the labor was performed and the material furnished in the amount claimed.

Mr. Green: That is agreed upon. [34]

The Court: It is agreed upon?

Mr. Green: There is no dispute as to the amount we are suing for.

Mr. McCall: I think that is in our admissions. It is in the file. I haven't checked them.

The Court: I haven't checked through the admissons, but frequently in these cases, as in mechanic's lien cases, there is an issue.

Mr. Green: That isn't an issue.

The Court: That eliminates a phase of the case that usually takes time. I am glad it is not present here.

Mr. McCall: There is a small amount, but not enough to talk about. The question here is strictly one of law.

I might say right now that the statement of facts that Mr. Green for the plaintiff gave here, if you will strip it of all of the conclusions, I believe it is correct, completely.

The Court: In view of the way the facts have developed in this pretrial, we may have a case here for motion for summary judgment. I am not saying you should do that, but I think you should consider whether to do it or not, provided, of course, that you stipulate that on the motion for summary judgment the transcript of the proceedings here today

would be a proper document for the court's consideration. Otherwise, the trial is going to be largely a repetition of [35] what we have had here today so far as presentation of facts is concerned.

Motion for summary judgment affords you, or will afford you, the same opportunity for briefing and argument that a repetition of these facts would do in the courtroom.

Mr. Green: I thoroughly agree, and I believe Mr. McCall agrees, this is a matter for summary judgment.

Am I correct in that assumption, Mr. McCall?

Mr. McCall: Yes, we have talked about that.

Mr. Green: So far as the briefs are concerned, do you intend to file any additional briefs than what you have filed?

Mr. McCall: After the facts have been stipulated to, it might be well for us to file further briefs.

Mr. Green: If you want to do that, that is all right.

Will you agree to this: that we may, without making a written motion for summary judgment, that we can at this time, so far as the defendants you represent are concerned, make a motion for summary judgment?

The Court: The rules won't permit it to be made orally.

It is all right with me, but the Court of Appeals for the Ninth Circuit has found upon that practice and has declared that a motion for summary judgment must be in writing, stating with great par-

ticularity exactly upon what it is based. So it really makes for a more orderly [36] process.

Mr. Green: I agree.

The Court: I have just had an experience with a surety-ship case, where the surety made a motion for summary judgment and the defendant did not. However, in the brief and in the argument it developed that there was a question of novation, which established an absolute defense.

On considering the plaintiff's motion for summary judgment, I wrote a memorandum on it that I gave the clerk just yesterday, and I decided that the surety company which was trying to collect, had substituted a note for the liability on the bond which had been discharged in bankruptcy.

Hence, the surety company couldn't collect from its client, but the defendant didn't file a motion for summary judgment on its behalf.

Mr. Green: May I suggest this—I think it would simplify this case—instead of a motion for summary judgment we can merely submit the case to the court for decision on the facts?

The Court: You could do that?

Mr. Green: And then you don't have the technicalities of summary judgment on one side or the other, but this way the court can find the facts and decide the law.

I don't imagine counsel would have any objection [37] if we hold the action as against the bank in abeyance; in other words, separate those two issues for trial; and as far as we are concerned, if we recover a judgment against these defendants,

we are not interested in pursuing it against the bank. If we don't, then, of course, we are interested in pursuing it against the bank.

The Court: They are kind of standby defendant.

Mr. Green: That is right. Do you have any objection to that, of being a standby defendant?

Mr. Horn: Can I interpose something?

The Court: Yes.

Mr. Horn: I am still sitting here in a fog as to why we are in this lawsuit. I would like very much if I can have some information about that. I get nothing from Mr. Green's brief. He gives me no law at all.

I have nowhere to start. I am not any type of magician, but just a plain lawyer.

The Court: Mr. Green is suggesting that he and Mr. McCall submit their case, stipulating that there be a severance as to you, and indicating, in the event the plaintiff should win in this case, he would dismiss as to you.

Mr. Horn: Is that proper under the procedure?

The Court: Yes. However, in case the defendant wins on the present submission, then we will try the case as to you.

Yes, it is possible under our procedure to [38] sever and try issues piecemeal.

These proceedings in chambers have been informal, but after the close of this pretrial we have had this morning, it appears that the facts are now all before us.

I do not want to cut you off, however. If you want a formal trial, by all means we will calender

this for some day shortly, and you can go ahead. Otherwise, you may stipulate, if you wish, that upon counsel for defendant giving counsel for plaintiff a letter and giving the court a letter admitting the genuineness of certain documents which he says are probably genuine, but which he wishes to verify, that the cause will then be submitted on whatever briefing arrangement or oral argument you wish to make.

Mr. Green: I would like to have oral argument. If the court could set a day for argument, both as to the facts and as to the law, I think that is all that would be necessary. Then the court could make a final determination.

Mr. Sturr: I think we still would like to submit a brief.

Mr. Green: I have no objection if you want to submit other law; but, frankly, unless you submit something new, I am satisfied to let the matter stand submitted.

The Court: Do you want to argue the matter before or after the briefs? [39]

Mr. McCall: I don't care about arguing, for the reason if we agree on the facts it would be a matter of law. We could submit that to the court on our briefs and the court can have plenty of time to read them over, and if the court wants argument, the court can order us in for argument. Is that sufficient?

Mr. Green: Before the court rules, I would like to express myself, if I may.

The Court: Yes.

Mr. Green: If counsel has any further briefing to submit, I would like to be given the opportunity to answer such a brief, if it needs answering.

I would like the court to set a day for discussion, with the understanding that we can sever it so far as the bank is concerned until our case is disposed of.

The Court: I always feel if there is a substantial question, or if any party feels there is a substantial question and wants oral argument, we should have it.

When I was in practice, I always resented appearing before one of the district courts of appeal here, which would come out and call the calendar and if you did not say, "All right," when they suggested it be submitted, they would sandbag you into it.

On the other hand, if you go to the division of the District Court of Appeal in San Francisco, where Justice [40] Peters sits, and if you say, "We submit the matter without oral argument," Justice Peters will sandbag you into making an oral argument.

I have found out later the reasons for that. The judges here have their conference with respect to the case at such a remote time to the day of argument that they feel that what happens in the courtroom in the way of argument is probably forgotten by the time they meet to confer.

Justice Peters, in his division, and our court of appeals in its, have conferences before they ever hear argument, and immediately before, and then

they have a conference on the decision immediately after the argument. Hence, it is quite practical.

I always feel here that I am benefitted by oral argument, if counsel really makes an argument and not a speech.

Mr. Green: Let us see what we have accomplished. May I summarize my understanding?

The Court: Yes.

Mr. McCall: Before we have a summary, I had just given my version of the facts in the case, what I claim constitute the facts, and I would like to know, since counsel has a copy of this, does he agree that the facts that I just pointed out here are the facts in the case; and, if not, [41] what is there in my brief that is not a fact?

Mr. Green: That is a fair question and I will answer it in a minute.

You don't have the date in June when the contract was accepted by the Government?

Mr. McCall: I do not have that date any place.

Mr. Sturr: Can we say sometime in June?

Mr. Green: I think so.

The Court: It would seem to me it would have the same legal effect if it were any date in June, even a Sunday.

Mr. Green: I take exception to this one statement on line 12 on page 2, where you say, "were paid in full by E. F. Grandy," as a conclusion. I have no objection to that fact being "were paid the full amount of the contract price by E. F. Grandy."

Mr. McCall: All right. I will be glad to make

that "were paid the full amount of the contract price."

Mr. Sturr: Subcontract price.

Mr. Green: "Were paid the full amount of the subcontract price."

Mr. McCall: "——were paid in full"?

Mr. Green: No, not in full. I object to that. "Were paid the sum of $16,667.05."

Mr. McCall: Is that the full amount of the subcontract [42] price?

Mr. Green: Yes; but I don't like the phrasing.

The Court: Mr. Green wants to follow pretty well the practical rules to avoid stating it in conclusion form, although he states an ultimate fact which leads us to a conclusion.

Mr. Green: The mere fact they paid the sum of $16,667.05 doesn't mean they paid in full for the contract, if they owed American Seating Company so much money. So, instead of "in full," I agree the amount of $16,667.05 was paid.

Mr. McCall: Make it "was paid the amount mentioned in the subcontract."

Mr. Green: That is longer than what I just said "were paid $16,667.05."

Mr. McCall: All right. Now, is there anything else to be stricken there?

Mr. Green: Just "in full," and substitute $16,667.05.

Mr. McCall: I don't think there is any objection to that. It is the same thing.

The Court: All right. I assumed there would be no objection so I have written it here, already.

Mr. McCall: Anything else you object to, Mr. Green, in the statement of facts?

Mr. Green: No. I don't claim they are all the facts, [43] but I don't object.

The Court: You feel, correlated with the facts you have stated here today, they are all the facts?

Mr. Green: Yes, they are, and I am willing to submit the case to the court on the correlation of both statements of fact which have been agreed upon, and the exhibits we have had marked here, so far as the defendants Glens Falls Indemnity Company and E. F. Grandy, Inc., are concerned.

The Court: That is assuming your opponent finds it possible to agree to the genuineness of the documents, which he has reserved.

Mr. McCall: There is a further point there, your Honor. We, I am sure, couldn't agree they are relevant or material.

The Court: I understand. Counsel's objections as to materiality and relevancy will be treated, I take it, either in the briefs or on the day of oral argument, or both.

Mr. McCall: All right. I will get Mr. Grandy up here, and we will look over these and see if he admits they were all received by him, or sent to whomever they purport to have been sent. There was some correspondence between Murphy, the subcontractor, and the plaintiff here, American Seating Company, and it might be that Mr. Grandy knows nothing one way or the other about it; and, if not, I will so state in my letter to the court and counsel.

The Court: All right.

Mr. McCall: Will it be sufficient if I write a letter to counsel or write it to the court?

Mr. Green: Write it to the court and send me a copy.

The Court: Technically, it should be sent to the court with a copy to counsel.

Mr. Sturr: Would it be agreeable to you, Mr. Green, if you can find the information to supply us with the information as to who made the call?

Mr. Green: That is a fact in dispute anyhow.

The Court: It is a fact in dispute upon something that isn't in issue.

Mr. Green: I will withdraw that. If we are going to submit the matter to the court this way, I won't even put that in as an issue.

Mr. McCall: You mean whether there was a phone call?

Mr. Green: Yes.

Mr. McCall: You have nothing in the record to substantiate that.

Mr. Green: I said that it was a fact——

Mr. McCall: You can withdraw it orally.

Mr. Green: Understand, I am not withdrawing it from the case, if we have to try the case, other than by submitting it on the stated facts we have now, and the court can ignore the question and eliminate from consideration any [45] question of the telephone call.

The Court: The court is to consider the facts in this case to be the facts recited in the pretrial brief of defendants Glen Falls Indemnity Company and E. F. Grandy, Inc., and the facts which have

been stated this morning by plaintiff, eliminating from such consideration all that has been said by either party about the telephone call.

Mr. Green: Yes.

The Court: If, however, the court should feel, or either party should feel, before the date we announced for trial, that there should be an actual trial as to the facts, then the matter of the telephone call is not prejudiced by what I have just said, but may be gone into.

Mr. Green: I reserve the right to present that at such time, if I decide to do so.

The Court: And I reserve ruling on whether it is material and relevant.

Mr. Green: In order to expedite counsel's work, I am handing him herewith these exhibits that have been marked Plaintiff's Exhibits 5, 6, 7, 8, 9, 10, and 11, for him to take and discuss with his client, and I will ask him to return those to me with the letter in which he advises us concerning their authenticity.

The Court: They are exhibits in the custody of the clerk. [46]

Mr. McCall: You don't have copies?

Mr. Green: No.

The Court: You are offering to stipulate, Mr. Green, that they may be withdrawn for the purpose of counsel determining with his client the genuineness, so he doesn't have to bring his client to the Federal Building, and will thereafter be returned to the files?

Mr. McCall: Mr. Clerk, have those been identified by you so that you can identify them?

Mr. Green: Mr. McCall, just a moment; I withdraw my offer. You come up to the court and see them. I don't seem to be able to agree with you even as to the time of day.

Mr. McCall: I want to know if they are identified by the clerk.

Mr. Green: Forget it. Withdraw it. If you want to see them, you come up to the court and see them.

Counsel for the bank has handed me the assignment, and wants it put in the file, and I will offer this as Plaintiff's Exhibit No. 16.

The Clerk: Plaintiff's Exhibit 16 for identification.

The Court: The court will now make this order, that we will try this case as to the defendants excepting the bank, and will excise from that trial all consideration of the bank; and if plaintiff desires to proceed as to the bank, that notice shall be given the court within ten [47] days after the notice of the court's decision, and the court will then have it placed on our setting calendar for trial as to the bank.

The bank need not appear at the trial which is about to be set.

It is understood, pursuant to stipulation, the court will consider the statement of facts with the exception of the deletion I have indicated, which has been made by counsel for the plaintiff, and the statement of facts which has been filed in writing by the defendants and which he has adopted by ref-

erence, rather than restatement, as the evidence in the case.

The court will consider the exhibits which have been introduced today, providing that the genuineness of certain of them which counsel were not prepared to concede is hereafter conceded by letter; and that on the trial of this case we will try the issues of law, counsel briefing those issues in advance of trial and appearing for such argument as they feel is indicated, and for such questions as the court might direct to them at that time.

It is also part of the order, and I understand it is the desire of counsel and so I make it a part of the order, that the pretrial briefs will be considered as a part of the argument in the case.

You haven't stipulated to it yet, but unless you [48] have some objection, I will make it part of the order, that all admissions and interrogatories on file will be considered as introduced in evidence.

I don't know if there are any, but usually in a case of this kind there are.

Mr. McCall: Yes, there are.

The Court: And I take it from the fact that they are not disputed, that you have liquidated that particular issue to your satisfaction by interrogatories.

Mr. McCall: Yes.

The Court: How long do you want for filing further briefs?

Mr McCall: Your Honor, it is my understanding that possibly when we go over the facts and brief this and submit it to the court, that the court

might set a time for argument, and that would be all we would have; is that right?

The Court: I understood you wanted to brief it. Mr. Green wanted to argue it orally.

Mr. McCall: Yes; after we brief it, I understand he wants to argue it.

Mr. Green: Maybe I won't.

The Court: Let us fix a day for the argument and have a day fixed for the filing of the briefs.

Mr. McCall: I think it is unfair to the court to have [49] to talk about these facts here that the reporter has taken down, without them first being transcribed, and I am just wondering if all counsel here would want to contribute to the reporter to transcribe these notes, so that we can get together and possibly cut out a lot of them and settle on the real facts.

The Court: You are suggesting you prepare an agreed statement of facts rather than the Judge wading through the full transcript?

Mr. McCall: Yes.

The Court: Actually, this is not a particularly long transcript, and having noted how you get on each other's nerves it seems to me a mutual attribute here, and I don't want to get you into further fights. If you wish to do that, it is agreeable to me; but unless you mutually request it, I would suggest that you let me wade through the transcript. It will not be such a difficult task. This has been a relatively short proceeding.

Mr. Green: The question the court asked you is how much time you want.

Mr. Sturr: We would like to know when the reporter can get a copy of the transcript to us.

Mr. Green: We would like to have the transcript for the satisfaction of preparing our own brief.

The Court: I would like, then, for you in your briefs to [50] brief the facts as well as the law. Spell out what the significance is of anything upon which you rely or which you contend is not what is argued by the other side to be. Take your time. I don't want to rush you. Of course, you want to get your lawsuit decided. I want to decide it as expeditiously as you would like to have it decided, but you tell me how much time you want.

Mr. McCall: We could cut this down if counsel wanted to hand in his prepared statement, just like we did, and say, "Here is our statement," and we will cut out all the conclusions. If he will write it up, we will agree to it.

Mr. Green: Counsel, the question is how much time do you want to write a brief?

The Court: We have a record here. It is not, perhaps, an Emily Post record, but it is a good legal record.

Mr. McCall: I would say, or I would presume that plaintiff has the first shot at the brief.

Mr. Green: We are willing to submit it on the briefs filed. If you want to file any more briefs, I want to know how much time you want, and if I want to answer, I will ask time to answer.

The Court: You are standing on your opening brief?

Mr. Green: Yes. We will stand on that, on our opening and reply briefs.

Mr. McCall: I would say ten days, and it may be that [51] after——

The Court: The court will order that either party may, but need not, file any brief in this matter within 20 days of the receipt of the transcript.

The reporter will notify the court when the transcript is prepared, and I will have a copy of it.

Within ten days of the filing of any brief which any party desires to file, the opposition may file the reply brief thereto. That will give us about 30 days from Monday.

Then we will set a day for trial, it being my understanding that in all probability after the examination has been made of these documents, all we will have to try is the issues of law and not take evidence.

So, we can, I think, set it down for some one day.

Do you want a lot of time for argument, or is it something that can be argued in a morning or in an afternoon?

Mr. McCall: Either one, half a day.

Mr. Green: Half a day would be sufficient.

The Court: It is rather easy to fill in a half a day. You are going to take the month of April for your briefing. Do you have your calendars with you so we can determine a convenient time in May?

Mr. Green: What about May 1st?

The Court: I could give you Friday afternoon, May 8. It is rather difficult to hit upon any day prior to May 8 in [52] the month of May, because

of other things I have placed on our calendar, but we can give you Friday afternoon, May 8, if you want to work on a Friday afternoon.

If counsel find themselves involved in some conflict which they would like to resolve by continuance, bring up a stipulation and we will continue the matter. If you cannot stipulate on it, bring up a motion for continuance.

Mr. Horn: Do I understand, in the event judgment should be for plaintiff against Grandy and the Glens Falls Indemnity Insurance Company, that we will be having forthcoming a dismissal as to the bank?

Mr. Green: When the judgment is sustained, when we get our money.

Mr. Horn: When you get your money?

Mr. Green: When the judgment is final, I will dismiss the case against you.

Mr. McCall: If the court decides he does not want it submitted piecemeal, he will advise all of us and the bank will come in.

Mr. Green: We would decide that. Mr. McCall isn't making the order. The court is making the order.

The Court: The clerk will make appropriate minute orders on today's proceedings, and this transcript, the original, will be delivered to the court and will be filed in the action. That will suffice, so far as the court [53] is concerned, for the pretrial order. But any party may, if it desires, reduce any order the court has made today to a formal order in writing, and may file such formal order after

having secured the approval of opposing counsel.

Los Angeles, Calif.; May 8, 1953; 2:00 o'clock p.m.

The Clerk: American Seating Company vs. Glens Falls Indemnity Company, et al. No. 14,305-T, for trial.

The Court: Are you ready?

Mr. Green: Plaintiff is ready.

Mr. McCall: Defendant is ready.

The Court: I don't recall who it was, but someone called up saying that they wanted to offer some more evidence in this case.

We had a pretrial and I understood the documents which came in at pretrial were admitted in evidence and constituted the whole evidence in the case.

However, if anyone has any additional evidence the court will not be a stickler for standing upon that understanding we had at pretrial that the evidence was in.

So go ahead and put it in.

Mr. Sturr: I was the one that did that. There was a letter from the plaintiff's manager here in Los Angeles to the defendant Glens Falls Indemnity Company that was referred——

Mr. Green: We have no objection, so, to save time, put it in evidence.

The Court: Go ahead and put it in evidence.

Mr. Sturr: That plus the prime contract. [66]

Mr. Green: No objection to the prime contract.

The Court: All right.

Mr. Green: We have just one thing to add if I may.

The Court: Let us take these defendants' exhibits first.

The prime contract and the letter, where are they?

Mr. Sturr: The letter was sent to your Honor two days ago and the prime contract was submitted to you personally in your chambers the first of this week.

The Court: The contract was what I asked you to take to the clerk's office?

Mr. Sturr: Yes.

The Court: The letter and the contract are here and also the letter of transmittal.

I will take the letter away from the letter of transmittal and ask the clerk to mark this as the defendants' exhibit next in order.

The prime contract which I have taken the liberty of going through, although it was not in evidence, it was apparent it was going to come in, but I have gone through it in order to get some familiarity with it, but it will be marked now as defendants' exhibit next in order.

The Clerk: The letter is Exhibit A and the contract will be B. [67]

(The documents referred to were received in evidence and marked Defendants' Exhibits A and B respectively.)

[See pages 174-175.]

The Court: Now plaintiff wants to put something else in.

Mr. Green: This is not really putting anything in evidence except counsel's answer to the interrogatories originally made were subsequently amended in a letter to me and I could either read the amendments into the record or just put this letter into evidence which would simplify it.

The Court: You are trying the case, so do whatever you want.

Mr. Green: I would like to offer at this time defendants' answer to Interrogatory No. 4 to read as follows:

Where it shows $61.37 at line 12, it should be $6124.37.

In Interrogatory No. 5 at line 17 where it says No. 6-16752 and Spec. 2-656, it should read, NOy 16752 and Spec 20656.

The answer to Interrogatory No. 8 is an admission that the defendant did have a copy of the purchase order.

Mr. McCall: Could I object to that? Counsel started out to read this and he makes conclusion that it is an admission.

To save time I would suggest that both the plaintiff's letter and the defendants' letter be introduced in evidence.

Mr. Green: Agreed.

Mr. McCall: No objection.

The Court: All right, you have agreed on that procedure. [68]

So, hand them to the clerk, who will mark them plaintiff's and defendants' next in order in each instance and will be received in evidence.

The Clerk: Plaintiff's Exhibit 17 in evidence.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 17.)

[See page 172.]

Mr. Sturr: This is the letter to which Plaintiff's Exhibit 17 is a reply.

The Clerk: Defendants' Exhibit C.

(The document referred to was received in evidence and marked Defendants' Exhibit C.)

[See page 176.]

Mr. Green: Just so the record will be clear, we offer these exhibits that were marked at the pretrial.

The Court: Each and every exhibit which was offered at the pretrial is admitted in evidence.

It is my recollection of the pretrial which was quite extended in this case that counsel were agreeable to their going into evidence at that time.

Understanding that they were in evidence I have read them all, but if I was wrong on that and they were only intended for identification they have now been offered?

Mr. Green: Yes, your Honor.

The Court: Then I will receive them.

Were you going to object?

Mr. Sturr: Yes. [69]

The Court: Then I will set aside the ruling that they may be admitted in evidence long enough to hear your objection.

As I recall, we said at the time of the pretrial it would be impossible to finally determine the rele-

vancy and materiality of these documents until we had heard the case.

Mr. Sturr: May we reserve our right to object to them?

The Court: We are hearing the case now and you are objecting now, is that right?

Mr. Sturr: Yes.

The Court: I will reserve ruling until we have heard the case and have heard your objections.

Mr. Green: Based upon the stipulated facts, your Honor, that were stipulated to in the pretrial and the exhibits that we have offered on the assumption that they will be received, we rest our case only with this change that when the admission of the defendant as to the amendment involving changing the figure $6124.37 to $6356.

The Court: Is that what you are asking the court to give you?

Mr. Green: Yes, your Honor, plus interest at the rate of 7 per cent since the date asked for in the complaint.

The Court: What is that date?

Mr. Green: 1st of June 1949.

With that we rest.

Mr. McCall: Do we understand counsel of plaintiff is [70] asking to increase the amount sued for in the complaint?

I do not have the complaint before me.

Mr. Green: Your understanding is correct. The amount should have been $6356. As you answered in the interrogatory.

The Court: You move to amend your complaint?

Mr. Green: I move to amend my complaint to conform to that proof.

The Court: The motion to amend the complaint is granted, but you had better take the complaint and amend it by interlining that.

Initial the interlineation.

Any further evidence by the defendant to be offered?

Mr. McCall: I was just waiting for Mr. Sturr, associate, to return to his seat so as I could ask him what he has found there.

As I understand, the interrogatories were signed by Mr. Grandy.

The Court: We will stand in recess until 3:00 o'clock.

(Recess.)

The Court: You may proceed.

Mr. McCall: May it please the court, if we have the facts in mind we would also rest.

I will see if I remember the facts as they are.

I have been out of town practically all the time since we had our pretrial. I would be called out for a few days [71] and then come back.

As I remember, at the pretrial your Honor suggested either side who wanted to could file a brief and then we would have the argument.

Since I was out of town so much Mr. Sturr took the matter up with the clerk, I believe, to find out if we could get another date, get the time extended to another date, but, as I understand, that did not suit the calendar of the plaintiff's attorneys and for that reason your Honor held that we would have

the argument on it today and then we could file briefs if we wanted to.

If my understanding is correct, our Honor, we also rest with the exception of the brief in question.

The Court Is it understood that the record of the pretrial here is also a part of the record of the trial?

Mr. Green: I so understood.

The Court: I understood at the pretrial we made it so.

Mr. McCall: I believe so. There was some question about the facts. Of course, the court has that record and can weigh the facts.

The Court: Yes.

Mr. McCall: There is one more thing that the court has to decide, I think, to wait until the briefs are all in, and that is whether or not the exhibits for identification will be introduced in evidence.

The Court: Yes.

Mr. McCall: We have objected on the grounds which are in the record, to some of them, and some of them we have specifically marked as those we would like to go in evidence.

The Court: Yes. Your objection goes to relevancy and materiality?

Mr. McCall: That is right, your Honor.

Mr. Green: Since all the evidence is in then I ask the court to rule on the exhibits. We want to know whether we have a case made or not.

The Court: Actually this type of objection goes to your ultimate decision in the case because it is

understood the foundation is there for the exhibits. It is simply a question whether they prove anything.

Mr. McCall: Yes, your Honor.

Mr. Green: The point is they go to the probative value that the exhibits have.

If counsel has any objection on any ground to the exhibits he ought to state those objections, and we should have those decided by the court at this time as to materiality or relevancy since we do have the foundation and we have offered them in evidence.

Also, if I may, I would like to comment on the fact that here my understanding was that at the pretrial we would present all the evidence to the court. [73]

The only question was whether or not counsel was going to admit the foundation for these exhibits. That has now been done.

It was provided for in the pretrial at that time that counsel would have 20 days to file any additional briefs and we have already filed additional briefs in the case and after the additional briefs in the case were filed we could argue the case if we wished.

Now, counsel says he had other business. I had other business and so did my associates and so did the court.

Now counsel says he wants to argue and then file briefs.

It seems to me that this is the day when this whole matter can be disposed of and should be dis-

posed of, I respectfully submit, if the court is fully advised of the facts and the law as I am sure the court is from the evidence already presented to the court and the briefs which have been submitted to the court.

The Court: Mr. Green, you have gone over the exhibits. I feel that I should do that in order to ground my familiarity for the purpose of ruling.

Mr. Green: Yes, your Honor.

The Court: It is still, perhaps, going to be difficult to rule with proper finality on the relevancy of a document until we have the argument.

I would like, however, for counsel to indicate at this [74] hearing which of the exhibits he objects to on the ground of relevancy and I will give that matter special study.

Then when I get to a decision on the case I will say in the memorandum that exhibit so-and-so is admitted and exhibit so-and-so is rejected.

So that you will have a record upon what I base my finding, but the nature of these exhibits is such that the question of relevancy rather than of weight to be given to these documents is what is to to be considered.

There are some things that are somewhat on the edge of relevancy in law and others that are right at the spoke of the wheel.

It is going to be difficult for me to give an absolute decision until I have heard your arguments.

Mr. Green: Yes, but if counsel has any defense he should submit it.

He has rested and now I would like to proceed to argue the plaintiff's case.

The Court: Let us get this matter of the exhibits straightened out.

Are you prepared to tell the court which exhibits you are objecting to on the ground of irrelevancy and incompetency and immateriality?

Mr. McCall: Yes. That has been made the subject of a letter addressed to the clerk and a copy sent to counsel for [75] plaintiff.

The Court: One was laid on my desk just before I came in from the recess.

Mr. Sturr: That was the letter of transmittal also of this additional exhibit.

In that regard we stated we do have no objection to Plaintiff's Exhibits for identification 2, 3 and 4, the subcontract and both bonds under the subcontract.

The Court: But you do object to which ones?

Mr. Sturr: We reserved the right to object to all other exhibits, that is, 1, and 5 through 16.

The Court: Which ones do you not object to?

Mr. McCall: We do not object to either of the letters.

Mr. Green: In view of counsel's attitude may I suggest that I do this?

I will offer these exhibits one by one and let them show the court where they are irrelevant and the court can rule on it and we will now know what the evidence shows.

The Court: You offer them and Mr. McCall and Mr. Sturr can state their objections.

If I can I will rule.

If I feel I cannot I will reserve ruling.

We will at least then have them in the record with the particular objections.

Mr. Green: We would like to first offer in evidence [76] Plaintiff's Exhibit 2 which was marked 2 for identification, which is the subcontract between Grandy and Murphy.

Mr. Sturr: We have no objection to that going in evidence.

The Court: Received.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 2.)

[See page 147.]

Mr. Green: Next we wish to offer in evidence Plaintiff's Exhibit 3 which was marked for identification at the pretrial as Plaintiff's Exhibit 3.

The Court: My notes show they were not objecting to that.

Mr. Green: Just to make it orderly——

The Court: It is received.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 3.)

[See page 153.]

Mr. Green: And the same with respect to 4.

The Court: There is no objection.

Plaintiff's Exhibit 4 is received.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 4.)

[See page 155.]

Mr. Green: We have No. 5 which is the bid made by the American Seating Company to all

contractors for this particular work in the sum of $6356. Which was received by E. F. Grandy on September 24, 1949 in accordance with their stamp [77] thereon.

Mr. Sturr: We do object to that on the ground it is irrelevant and immaterial.

Mr. McCall: That is the extent of the objection, irrelevant and immaterial to the issues of the case.

The Court: Do you want to argue this?

Mr. McCall: No, we are willing to leave this until the briefs are in.

The Court: I will admit it and you can make a motion to strike it in the briefs.

It appears to me in the full setting of this case that while Exhibit 5 does not spell victory for any party, it is not a document that you would refer to as being the crux of the case, but it is relevant with a liberal view of relevancy.

It is admitted in evidence and leave is given to you to file a motion to strike contemporaneously with filing your brief.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 5.)

[See page 156.]

Mr. Green: We offer No. 7 for identification, the purchase order from V. L. Murphy Company to American Seating Company for this material for which we are asking the purchase order which was received by E. F. Grandy on September 24, 1949——

Mr. McCall: We have no objection to that going in evidence. [78]

The Court: Received.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 7.)

[See page 161.]

Mr. Green: ——which is the letter from American Seating Company to V. L. Murphy dated August 23, 1949, which discusses the subject matter of this action, a copy of which was sent to E. F. Grandy, Inc., according to the note at the bottom and was received by E. F. Grandy on August 25, 1949.

Mr. McCall: We have no objection to that going in evidence.

The Court: That has been received.

Mr. Green: We now offer Exhibit 8 which was marked for identification as Exhibit 8, a copy of a letter from E. F. Grandy, Inc., to the officer in charge of construction relative to this particular matter and dated September 26, 1949.

This is a letter of transmittal, transmitting four copies of the purchase order for this material to the Government and was transmitted by E. F. Grandy, Inc.

Mr. McCall: No objection.

The Court: Received.

(The document referred to was received in evidence and marked Plaintiff's Exhibit No. 8.)

[See page 163.]

Mr. Green: We offer in evidence an exhibit marked for identification as No. 9 which is a letter to E. F. Grandy [79] dated December 20, 1949 from

American Seating Company discussing the subject matter of this action.

Mr. Sturr: We do feel that this is immaterial in the sense that it is nothing more than a report from this company to a prime contractor.

The Court: The Court is not satisfied of the relevancy either.

It might be relevant but at the moment I cannot say with a certainty so I will reserve ruling on that and invite your comments in argument.

Mr. Green: We offer Plaintiff's Exhibit No. 10 for identification, a letter to the officer in charge of construction from E. F. Grandy, Inc., dated December 22, 1949, enclosing correspondence, copies of correspondence from American Seating Company relevant to the subject matter of this action.

Mr. McCall: Our objection to that would go to the fact that it mentions documents which we do not have here or know what they are.

We think it is irrelevant and immaterial on that ground.

Mr. Green: It is not the documents they mention that makes it material.

The purpose of these documents is to show the notice that E. F. Grandy had of the fact that American Seating Company was the supplier of material to its subcontractor in [80] connection with this work, something counsel has attempted to deny and admit in various forms.

I want to have that clarified.

The Court: It is my tentative view that this document is admissible.

However, because there has been an objection and my view is still tentative enough that I am sort of standing on it with one foot instead of both I don't have too much confidence in my understanding of relevancy.

I will reserve ruling on this until after argument.

Mr. Green: We of course defer to the Court's ruling and agree that the Court should not make any final ruling on anything until the Court feels certain about it.

For the purpose of the record, it should show these are all photostats which the defendant has stipulated are photostats of the original documents and are true and correct.

This exhibit marked 11 for identification is a letter from E. F. Grandy dated January 6, 1950 discussing the material supplied in connection with——

Mr. Sturr: We do object to that, first, because it refers to a letter which may have some relevancy; and, second, on the ground it seems to be nothing more than a letter from the prime contractor to supply the material.

The Court: It doesn't seem to me offhand to prove anything in your case one way or the other.

How relevant is it, Mr. Green?

Mr. Green: The reason I cannot speak with authority as to how relevant it is, is because I had no idea what the defendant is going to claim as a defense in this case.

The Court: I don't either.

Mr. Green: I don't see where they have any defense.

They may bring anything.

They may say that E. F. Grandy and Company never heard of American Seating Company.

I cannot imagine what they may say.

The Court: They have rested their evidence.

Mr. Green: I know, your Honor, that is why we want to put these things in and have them in the record.

The Court: We are sort of backtracking to the plaintiff's case in order to get a record because of uncertainty as to what the present record is.

Now having any defense presented as to which this would be relevant the objection is sustained as to No. 11 with permission to reoffer if anything is presented which would make it relevant.

Mr. Green: We now offer in evidence the exhibit marked No. 12 for identification.

We will pull out No. 11.

I want to conform to the Court's idea of relevancy here so we do not burden the Court with anything that is not [82] necessary.

The Court: I see your position, Mr. Green. You don't know what they are going to argue, so you want to bring in everything you consider an answer to everything and not knowing what everything is you bring, perhaps, too much.

Mr. Green: Perhaps much of this is surplus, but I assumed when we came to court today that their position would be clear and if they had any brief they would have filed it.

These documents conclusively prove there was a contract between Grandy and American Seating Company and the reading of the bonds and our application show.

So, in order to clarify it, considering the acts of Grandy who took steps right at the beginning of this contract which virtually disabled Murphy from paying American Seating by agreeing to an assignment of those funds——

Mr. McCall: We would object to that as a self-serving argument after he has rested.

Mr. Green: Mr. McCall, all my arguments are self-serving in the interests of my clients. That is my purpose.

I want also to point out to the Court that E. F. Grandy have disabled Murphy from paying American Seating Company by permitting them to assign funds to a bank and paying the money to a bank before these goods were ever even——

The Court: Let us have the offer of evidence.

Mr. Green: We offer Exhibits 14, 15 and 16 in evidence [83] also.

The Court: Is defense objecting to Exhibits 14, 15 and 16?

Mr. Green: We also offer in evidence Plaintiff's Exhibit No. 1.

Mr. Sturr: We don't object to 14, 15 and 16.

The Court: They are received in evidence.

(The documents referred to were received in evidence and marked Plaintiff's Exhibits Nos. 14, 15 and 16.)

[See pages 169-172.]

Now, what about No. 1?

Mr. Sturr: We do object to No. 1 on the ground it is nothing more than a letter from E. F. Grandy, Inc., to V. L. Murphy acknowledging receipt of a letter and——

The Court: This is offered to show, I take it, notice or a recognition and I don't know definitely about this, so I will reserve ruling on No. 1 until we have argument.

Mr. Green: We offer Exhibits 12 and 13.

Mr. McCall: We have no objection to either of those.

The Court: They may be received in evidence.

(The documents referred to were received in evidence and marked Plaintiff's Exhibits Nos. 12 and 13 respectively.)

[See pages 166-169.]

Mr. Green: I would like to ask the Court to inquire of the defendant whether they have any evidence to offer, or whether they have rested.

The Court: They have told the Court they rest. If they want to reopen I will let them.

Do you want to rest or do you want to reopen?

Mr. McCall: Your Honor, I believe that exhibits we presented to the Court have been introduced and received.

The plaintiffs put in the contract and the bonds, which is our main defense, and subject to the brief we will write with the Court's permission we rest.

The Court: That brings us to the time of argument.

Are you prepared for oral argument today?

Mr. McCall: I was willing to waive oral argument if we filed briefs.

The Court: Do you mind relieving me somewhat of judicial suspense?

Tell me the defense to this action and write the brief and back it up.

I would like to know what you are driving at and why you don't want to pay this money.

Mr. McCall: The bond specifically says that it is an indemnity bond to wholly indemnify Mr. Grandy in the event he suffered a loss which he has not suffered.

The Miller Act which was the Hurd Act up until 1935, as your Honor knows, gives a specific remedy to furnishers of labor and material, and spells it out so no one can be mistaken.

If that is the act that they are filing under here they [85] are long, long too late.

If they have waived their rights under that act they still have no right to come back again on a bond which provides on its face that it is an indemnity bond.

We have case in California holding that in the case of that kind there is no liability on the part of the surety until the man in the place of Grandy has actually paid out the money and then he is to be reimbursed.

That will be covered, I think, better in our briefs than we can in argument.

The Court: That begins to orient the Court to what your position is.

I have been wondering here why, when what ap-

peared to the Court to be a conventional plaintiff's case was before the Court without any challenge on its being so.

Now you have presented a question and I will have to search that bond to see if it is as restricted as you claim and whether the facts here are such as to support a recovery under it.

Do you see what his point is, Mr. Green?

Do you want to comment on it?

We are going to have briefs, but how are you going to get over that hurdle?

He says the bond comes into operation only when your client has suffered loss, by having paid out the money. [86]

Mr. Green: I would like to know if those are the two points they are relying on. Is that so, Mr. McCall? Because as soon as they are answered he will have another point and I would like to know just what I am required to answer.

If those are the two points you are relying on I could answer in a moment.

Mr. McCall: I did not think the defendants were limited to two points in a lawsuit.

The Court: You can raise as many points as you want. That is the law and I am glad it is the law because it is my personal disposition to hear everything.

In the interest of orderliness I like to hear everything you are going to urge extenso in your briefs just so long as we have it in capsule form here, so we know what you are driving at.

Do you have any other specific defense in mind?

Mr. McCall: Of course, until we have prepared our brief, just on the spur of the moment there might be some defenses I wouldn't have in mind, but that is the main sense I just called out to the Court.

Maybe Mr. Sturr has something he would like to say.

He has carried the laboring oar while I have been out of the city.

The Court: He is a very capable young man. We are glad to have him here. If you have seen anything wrong with the [87] plaintiff's case that Mr. McCall has not pointed out, will you point it out?

Mr. Sturr: Yes, if the Court please, just the fact that we can find no indication, even with all the exhibits, by the greatest stretch of the imagination we find no contract between E. F. Grandy and American Seating Company whereby E. F. Grandy promised to purchase these materials and pay for these materials.

Furthermore, we do contend that since there are two bonds, the payment bond and the performance bond, that there is no doctrine of law that says merely because you have a bond anybody can recover on it.

We do claim that the plaintiff and defendant cannot recover on the bond because there were two bonds basically and the performance bond was not intended to cover any loss by reason of failure to pay for material and labor.

The Court: When you write your brief do so in a manner as if you were writing it for a teacher

on the subject when you were back in school and assume it is a teacher who is not too bright.

I am not confessing to that condition, but I like you to——

Mr. Sturr: I would assume also the student is not too capable.

The Court: I like to have it framed so that we can get [88] it easily.

Mr. Green: Are you through with the stating of your defenses, Mr. Sturr?

Mr. Sturr: Yes.

Mr. Green: May I ask this question? I asked you once before and maybe I can get an answer:

Do you claim the Miller Act is the exclusive remedy?

Mr. Sturr: I am making no claim the Miller Act is the only way a subcontractor can recover. I am making no claims.

Mr. Green: Counsel made a statement the only way a man could recover was under the Miller Act. You know the Miller Act is merely an additional remedy given to the subcontractor and it is not an exclusive remedy, isn't that true? Isn't that what your research shows?

Mr. Sturr: I don't claim that my research shows that.

Mr. Green: Do you claim the Miller Act is an exclusive remedy?

Mr. Sturr: I don't claim anything.

Mr. Green: I would like to be heard then this afternoon.

The Court: Go ahead.

Mr. Green: This has been pending for over a year.

Counsel says it came up by surprise. We have had demands for admissions and interrogatories served and we have had conferences and conferences and it was set for trial and the Court ordered at the pretrial that briefs, if any, be submitted [89] within 20 days after receipt of the transcript and they tell us this all came up by surprise.

The Court: Let's get to your answer to their defense.

You have made out, in the Court's mind, a case, unless we have overlooked something which they tell us, namely, that the Miller Act is exclusive and that you are out under the Miller Act, that you are too late.

Mr. Green: We are not suing under the Miller Act and counsel does not have the temerity to tell the Court that.

The Miller Act is one additional remedy given under certain circumstances.

The Court: I understand Mr. Sturr did not go that far, but Mr. McCall did.

What are you suing under?

Mr. Green: We are suing under a common law bond that was furnished by the subcontractor to Grandy in two bonds, one a payment bond and one the completion or performance bond.

Now, they take the unique position and the authorities they have cited in their brief on file here states you cannot recover under a performance bond if there is a payment bond because the theory is

that the payment bond is intended to protect the material men.

Then they cite another case that says that if you have a payment bond you cannot recover on the payment bond until the contractor to whom the bond was given is already paid. [90]

This is an action aganst Grandy as well as the bonding company.

We can simplify this matter very easily: Give us our judgment against Grandy. Once that is done they admit that then the payment bond comes in and they have to pay.

We are not, as I heard this Court make a comment earlier today, we are not back in the Sixteenth Century in our new Federal procedure. The purpose is to have all these matters adjudicated at one time if possible.

Certainly he does not claim under our enlightened procedure it is necessary for us to get a judgment against Grandy and Grandy has to go and sue them on the bond to recover.

The Court: I understood him to say that was so.

Mr. Green: He has cited a case as authority for that proposition.

The Court: As I understood it, on the general theory of the law, or suretyship in law school, and one of the Supreme Court Justices of the State of California today was one of my teachers in law school, teaching suretyship, you must not only get a judgment but you had to have a return that was uncollectible.

Mr. Green: That is not the law.

The Court: That was the law 30 years ago.

Mr. Green: The cases in California—and it is California law we are concerned with—early decided that and I [91] refer specifically to Pacific States Company vs. United States Fidelity and Guaranty Company.

I don't know whether the Court has read that case. We have these briefs on file with the Court and maybe the Court has read them.

The Court: I have read the exhibits but have deferred reading the briefs until I have heard the argument.

When I say what I understand the law to be I am speaking of a loose understanding based upon memory or cases I had in private practice or cases in law school, because I have not had this exact question arise in my practice for over 15 years and you can get very rusty on a question of suretyship in 15 years.

Mr. Green: In that case, the Pacific States vs. United States Fidelity and Guaranty Company case there was a claim of a material man against the surety bond which was given to pledge the faithful performance of a subcontract for the construction of specific parts of a building.

This is the performance bond that we are talking about now. And there they had almost the identical language of this performance bond.

In that case the Court of Appeals of California held a bond given for the faithful performance of a contract binds the surety for labor performed and materials furnished thereunder as completely as

though the surety were the party to the [92] contract.

That is exactly this situation.

They held in that case the performance bond required that the surety pay the material man of this subcontract—and we cited that case in our brief.

Counsel has not answered that they attempted to distinguish or argued in any way.

The Court: That case further said that a bond which undertakes a guarantee of faithful performance of a subcontract to furnish all necessary labor and material for a specified portion of a structure implies a promise to pay for such labor and materials furnished.

Furthermore, the Court said that the bond is not a pledge for the sole benefit of the general contractor but inures to the benefit of any person who performs labor or furnishes materials which are used in the structure pursuant to the provisions of the subcontract.

Much later, the California courts in the case of Christie vs. Commercial Casualty Insurance Company, 6 Cal. App. 2nd 711, held that an employee of a subcontractor could recover against the surety on its bond given in connection with the building of a public roadway for work performed by him in connection with said contract.

The court said:

"A common law or statutory bond to secure the [93] attainment of labor performed on public work pursuant to a contract should receive a liberal con-

struction so as to fulfill the evident purpose of bond."

The Court further said:

"In accordance with the California cases and ordinary statutory or common law bond to secure the payment of claims for materials furnished or labor performed should receive a more liberal construction of the language to carry out the evident intention of the parties to the instrument."

There are many other cases cited in the brief to the same effect and I want to call the Court's attention——

The Court: I am going to read everything cited in the brief.

Mr. Green: The only purpose I have in making this argument now is that these things have not been challenged by the defendant.

What I have stated is the law and I don't think the Court needs to be burdened unless counsel can challenge this.

The Court: Maybe they are going to challenge them.

Suppose we fix times for the briefs.

Mr. Green: We have in this Pacific States case another phase of it and I want to call that to the Court's attention.

This was exactly a similar situation where the principal [94] contractor had filed a statutory bond with the State in doing the job and then the subcontractor filed a payment and performance bond.

This is what the court said:

"The obligation of the respondent,"—referring

to the bonding company on the subcontractor's bond —"in the present cases to guarantee payment for labor performed and materials furnished under the subcontract seems fixed and certain. The fact that these claimants may have been entitled to recover compensation from the original general surety, Metropolitan Casualty Insurance Company,"—and this was the surety under the statutory bond furnished by the contractor to the owner—"does not release the respondent from the clear obligations of its contract."

The cases cited by counsel in their brief include the case of Albert vs. American Casualty Company, which has nothing to do with this case, and the case of Ramey vs. Hopkins, which is a case in which the court held that there is no distinction between an indemnity agreement providing for indemnity against loss and damage, and one against failure for completing the building fully contracted for.

They said in that case they should go after one of the bonds rather than the other bond, but here we have bonds and [95] in that case they held, and this is the language:

The suit was brought against both the contractor and the surety and judgment was recovered against both. The court which reversed it as against the surety sustained the judgment against the contractor on the theory that the liability of the contractor was clearly established.

In other words, they reversed it as to the surety on their theory of the case but they held the judg-

ment against the contractor so that the contractor could collect from the surety.

In this case, your Honor, again we can sever this situation as we did where the bank was concerned.

We can sever this by judgment at this time against Grandy.

There is no question that Grandy is the man who sent these purchase orders on to American Seating Company, who knew that American Seating Company furnished this material—and didn't pay them.

Certainly, there is at least an implied contract on their part to pay for anything as was seen in the Ramey case that they cite.

The contractor is liable without any question.

So it doesn't make any difference if you at this time give us judgment against Grandy and then we may never have to act on the bonds because I am sure that the bonding company [96] will pay but Grandy has to pay and we will be all through.

These defendants in this case have thrown in nothing but smoke screens. I don't wonder that the Court wonders what their defense is.

Up to this point their defense is included in the memorandum brief filed with this court and now they say 38 days from the pretrial they still haven't come up with a single case to call to the Court's attention.

Mr. McCall makes the statement to this Court that the Miller Act is exclusive or gives the exclusive remedy or tries to give the Court that impression.

Then his associate, who apparently did the law work will not say that is an exclusive remedy.

I want to call the Court's attention to the language of that Miller Act and the decisions which make it an additional remedy:

"Whenever there is a relationship that any person having direct control relations with the subcontractor, but no control relationship, express or implied, with the contractor, furnishing said payment bond, shall have a right of action on said payment bond."

In this case we have a situation where the subcontractor's material men, the American Seating Company had an implied contract with the E. F. Grandy and Company. [97]

That is what all these exhibits show. They show that the purchase order went right through Grandy's hands to the Navy and back to American Seating, that they were the ones who had all the relationships with American Seating Company. They were the ones who set up the specifications and they were the ones who also encouraged the subcontractor to dissipate his funds by assigning them to someone else when they know, or certainly in the exercise of any business judgment should have known that he would need these funds to pay his material men.

Instead of that they say, "Go ahead and assign them to someone else."

The record here shows the payments made before this job was even completed to the bank for Murphy, without giving any consideration or any thought to seeing that American Seating Company got paid.

This is not a Miller Act case and no action was brought under the Miller Act.

Under the Miller Act we could have brought an action in a certain period of time against the United States Government, against Grandy's original bonding company and got our money.

We didn't do that because we were misled by Murphy who said he didn't get his money from the Government and couldn't pay.

So no action was taken under the Miller Act and we are suing on these indemnity bonds that were furnished by Glens [98] Falls.

But let's forget that.

We are suing for the reasonable value of the merchandise furnished to Grandy.

He took the merchandise and put it in his shop and got paid for the job.

If, instead of the Government it was your house or my house then of course a lien could have been filed against that house.

Against the Government you cannot file a lien.

So, when we make the claim you see what happens. They come up over a year after the lawsuit, let alone almost two and a half years after they had noticed this claim——

The Court: They say you first have to go to Grandy and then if he doesn't pay you go to them.

Mr. Green: We are going to Grandy.

This is an action against Grandy.

Give us a judgment against Grandy. We will be satisfied.

The Court: Are you abandoning your plea for judgment against Glens Falls?

Mr. *Miller*: We are not abandoning our plea for judgment against Glens Falls.

We are absolutely entitled under the California law and these other laws to judgment against Glens Falls, but we are willing to separate our claim against the Glens Falls at this [99] time and give us judgment against Grandy and if we collect that we don't have to litigate against anybody else.

The Court: I understood the defendant wanted to file briefs and he is content on the argument made.

If you want to argue it further, Mr. Sturr or Mr. McCall, either or both of you may.

If you want to file briefs instead of argument, ask for any reasonable time bearing in mind the Court wants to get this case off the books during the month of May.

Mr. McCall: I presume from what has been said here that counsel for plaintiff does not care to file the first brief as I understand his right would be.

Therefore, we would like to have, if the Court please, and counsel, 20 days within which to file a brief.

Mr. Green: They were given 20 days once before and did not take advantage of it.

Mr. McCall: I am not sure we need that much time but I do have some other commitments.

The Court: The Court will ask for concurrent briefs, that is, plaintiff and defendant. Of course,

we have a plaintiff's brief which appears, on just cursory examination, to be very full.

Mr. Green: We are willing to rest on our brief.

The Court: If you want to consider that your concurrent brief you may. [100]

I will give both sides time to file a brief, but it is not required because the principles in this case are rather simple and if no one files any briefs and my law clerk and I can go into the library, we can work it off in a couple of hours. If you can save us that couple of hours with briefs that are complete enough with quotations, you may be sure I will read all of them.

Mr. McCall: The Court's remarks on suretyship remind me of a man who was asked if he studied Latin in school and he said, "Yes, but if you are going to question me on it, proceed as if I never had."

We already have briefs but——

The Court: I will give you until May 20 to get in whatever further briefs you desire, but if you act on that please make them full briefs in the sense of pointing out your contentions and quote any flinching language from any authority you have.

Those briefs will be due by the close of business of May 20th.

Do you want the opportunity to answer anything?

Mr. Green: I don't know what counsel can give us that will require any answer.

If any answer is required we will ask for permission at that time.

Mr. Sturr: The question was if you want a chance to answer? [101]

Mr. Green: Sir?

Mr. Sturr: The question was if you wanted a chance or an opportunity to answer.

The Court: You have been clamoring for early disposition of the case and I am trying to give it to you.

I had in mind if you get your briefs in on the 20th, the law is pretty well settled on these things, and if someone is off base and is urging a point which is utterly fallacious so far as the law is concerned, of course, they might want to place an interpretation or the facts which could be, of course.

The briefs will be due by June 20 and any party may put in an answering brief by the 25th.

Mr. McCall: That is very, very fair.

The Court: On May 25 at 5:00 o'clock the matter will stand submitted.

[Endorsed]: Filed February 25, 1954.

PLAINTIFF'S EXHIBIT No. 1

V. L. Murphy, May 12, 1949
1117 Obispo Ave., Long Beach, Calif.

Dear Mr. Murphy:

Your letter of May 11th, requesting payment clause, received and noted. We have inserted in your white copy of the contract, returned herewith, a clarification of our payment method on Federal or

Public work, which has in the past been both fair and satisfactory to all parties concerned.

You will, no doubt, understand our position relative to demand payments by our sub-contractors on or before the 10th of the month, since the operation of these jobs, as you are well aware, requires a rather substantial investment.

I might recommend, should additional operating capital be required, that this sub-contract may be assigned to the Bank with whom you are regularly depositing.

Hoping that this will be satisfactory, we remain,

Yours very truly,

E. F. GRANDY, INC.

efg:h—encl.

By .....

Marked for Identification April 1, 1953.

PLAINTIFF'S EXHIBIT No. 2

[Letterhead of E. F. Granby, Inc.]

SUB-CONTRACT

4 May, 1949

Project No. NOy-16752, Spec. 20656, Conversion of Bldg. IS-16, U. S. Naval Ammunition & Net Depot, Seal Beach, Calif.

To: E. F. Grandy, Inc., Gen. Cont.
Laguna Beach, Calif.

The undersigned as Subcontractor hereby undertakes and agrees to perform and complete that por-

tion, hereinafter specified, of the work to be performed and completed under and by virtue of that certain authorization dated the 29th day of April, 1949, between yourself as Contractor and Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, for the United States Government, as Owner and the plans, specifications and conditions described or referred to therein; said work to be performed and completed subject to said contract, plans, specifications, and conditions which are and each of them is hereby made a part hereof by reference as though set at length.

Subcontractor agrees to furnish all materials, labor, tools, machinery, equipment, light, power, water or other things necessary to perform and complete the following portion of the work:

Plumbing and Piping; per Section 17, Spec. 20656, Y & D Drawings, No. 417042 thru 417055.

Progress payments will be made in the following manner. Sub-contractor shall submit to the Contractor, before the 1st of each month, subsequent to that month in which materials or services have been furnished or performed, invoices for such material or service. These invoiced amounts will be incorporated into progress estimates submitted, to the Officer-in-Charge of Construction for approval and authorization of payment, on or about the 1st of each month during the life of the contract. Upon Contractor's receipt of payment (normally in about 20 days, for 90% of the amount approved), the Contractor will issue payment in the amount approved, less 10%.

The work to be done hereunder shall be commenced at the time and place to be designated by Contractor and shall be performed without interference with or hindrance of any of the other work being performed under said contract and subject to the schedule and progress thereof and shall be completed on or before the 1st day of September, 1949, subject to such extension of time as Contractor shall deem justifiable for delays caused by acts or neglect of Contractor or Owner from any liability for damage, loss, or injury to Subcontractor resulting from delay.

The total price to be paid to Subcontractor shall be Sixteen Thousand Six Hundred Sixty-Seven and 05/100 Dollars ($16,667.05) lawful money of the United States, no part of which shall be due until five (5) days after Owner shall have paid Contractor therefore, provided however that not more than ninety (90) per cent thereof shall be due until thirty-five (35) days after the entire work to be performed and completed under said Contract shall have been completed to the satisfaction of Owner, and provided further that Contractor may retain sufficient moneys to fully pay and discharge any and all liens, stop-notices, attachments, garnishments and executions. Nothing herein is to be construed as preventing Contractor from paying to Subcontractor all or any part of said price at any time hereafter as an advance or otherwise.

Subcontractor shall indemnify and save harmless Contractor and Owner from any and all loss, damage, liability or injury resulting from, arising out

of, or in connection with said work or any part thereof and shall furnish to Contractor at Subcontractor's expense valid Public Liability, Property Damage insurance in amounts and written by companies satisfactory to Contractor and shall carry and maintain Workmen's Compensation insurance in amounts and written by companies satisfactory to Contractor.

The Subcontractor agrees to indemnify and save harmless the Contractor and the Owner of said buildings against all damages which they or either of them may sustain by reason of anything to be supplied hereunder being covered by a patent not owned by the Subcontractor, or by reason of the use by the Subcontractor of any art, machine, manufacture or composition of matter on said work in violation of any patent or patent rights or infringement thereof, and at the expense of the Subcontractor to defend any action brought against the Contractor or the Owner, founded upon the claim that any such thing, or any part thereof, infringes any such patent.

Unless specifically waived by endorsement hereon Subcontractor shall furnish at Subcontractor's expense a performance or completion bond in any amount and with sureties satisfactory to Contractor.

Subcontractor shall be liable for and indemnify Contractor and Owner for all loss, damage, liability or injury resulting from, arising out of, or in connection with any delay in the performance or com-

pletion of the work to be done hereunder or any breach hereof.

During the progress of the work and until the date of completion and acceptance of the building the Subcontractor shall in every respect be responsible for and shall make good all loss, injury, or damages to the building, and shall maintain insurance, (including earthquake insurance) covering all work incorporated in the building and all materials for the same in or about the premises, the policies to be made payable to the Contractor and the Subcontractor as their interests may appear.

Subcontractor shall, if so requested by Contractor, perform and complete any extra work or changes hereunder and no charges therefor shall be due or payable except upon agreement in writing made prior to the commencement of said extra work or changes.

Contractor or Owner may personally or by agents inspect, direct or supervise all work to be done hereunder.

The Subcontractor agrees that in the preparation of his material and the erection of his work on the building he will employ only such men as will work in harmony with the other men employed by the Contractor.

Upon the breach of this subcontract in whole or in part or upon any assignment thereof voluntary or by operation of law or upon commission of any act of bankruptcy by Subcontractor or upon the death of Subcontractor or upon Subcontractor's failure or refusal to do any of the work to be done

hereunder to the satisfaction of Contractor, Contractor may at his option personally, by agents, or other subcontractors perform and complete said work for the account and at the expense of Subcontractor and withhold from the price to be paid hereunder sufficient funds therefor.

All moneys due and payable hereunder shall be payable at the office of the Contractor in the City of Laguna Beach, California, and if Subcontractor is more than one individual, payment to any one thereof shall be payment to all.

This contract may not be assigned nor the work to be done thereunder subcontracted in whole or in part without the written consent of Contractor first had and obtained.

Subcontractor shall not place, permit to be placed, nor maintain any signs or other advertisements in, on, about, nor in the vicinity of said work, without written permission from the Contractor.

Yours very truly,

/s/ By V. L. MURPHY,
1117 Obispo Ave., Long Beach, Cal.

Accepted this 4th day of May, 1949.

E. F. GRANDY, INC., GEN. CONT.
/s/ By E. F. GRANDY

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 3

[Letterhead of Glens Falls Indemnity Co.]

No. 427357

PERFORMANCE BOND

Know All Men By These Presents, That we, V. L. Murphy, doing business as V. L. Murphy Plumbing Co., as Principal, and Glens Falls Indemnity Company, a New York Corporation, as Surety, are held and firmly bound unto E. F. Grandy, Inc., hereinafter called the obligee, in the penal sum of Sixteen Thousand Six Hundred Sixty-seven and 05/100 ($16,667.05) Dollars for the payment of which sum well and truly to be made, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally, firmly by these presents.

The condition of this obligation is such, that whereas the Obligee entered into a certain contract, with the Government, dated April 29, 1949, for conversion of Bldg. IS-16, U. S. Naval Ammunition & Net Depot, Seal Beach, California, NO6-16752, Specification 20656 and,

Whereas, said Principal entered into a written subcontract on the 4th day of May, 1949, with E. F. Grandy, Inc. for Plumbing and Piping; per Section 17, Specification 20656, Y & D Drawings No. 417042 thru 417055.

Now, Therefore, If the principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements of said contract during the original term of said contract and any extensions thereof that may be granted by

the Government, with or without notice to the Surety, and during the life of any guaranty required under the contract, and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions and agreements of any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then, this obligation to be void; otherwise to remain in full force and virtue.

In Witness Whereof, the above-bounden parties have executed this instrument under their several seals this 18th day of May, 1949, the name and corporate seal of each corporate party being hereto affixed and these presents duly signed by its undersigned representative, pursuant to authority of its governing body.

V. L. MURPHY PLUMBING CO.,
/s/ By V. L. MURPHY, Principal

GLENS FALLS INDEMNITY COMPANY,
/s/ By LEO G. LEVENS, Attorney

Premium for this bond is $166.67 for the period thereof.

Duly Verified.

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 4

[Letterhead of Glens Falls Indemnity Co.]

Bond No. 427357

PAYMENT BOND

Know All Men By These Presents, That we, V. L. Murphy, doing business as V. L. Murphy Plumbing Co. as Principal, and Glens Falls Indemnity Company, a New York Corporation, of Glens Falls, New York, as Surety, are held and firmly bound unto E. F. Grandy, Inc., hereinafter called the Obligee, in the penal sum of Eight Thousand Three Hundred Thirty Three and 58/100ths ($8,333.58) Dollars for the payment of which sum well and truly be made, we bind ourselves, our heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

The Condition of This Obligation Is Such, that whereas the said Obligee entered into a certain contract with the Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, for the United States Government, dated April 29, 1949 for Conversion of Bldg. IS-16 U. S. Naval Ammunition & Net Depot, Seal Beach, Calif., NO6-16752, Specification 20656

Whereas, said Principal on the 4th day of May, 1949 entered into a written subcontract agreement with E. F. Grandy, Inc. for Plumbing and Piping; per Section 17, Specification 20656, Y & D Drawings No. 417042 thru 417055

Now Therefore, If the Above Principal shall indemnify and hold the said Obligee free and harm-

less from and against all loss and damage by reason of its failure to promptly pay to all persons supplying labor and materials used in the prosecution of the work provided for in said subcontract, then this obligation to be null and void, otherwise to remain in full force and effect.

Signed and Sealed this 18th day of May, 1949.

V. L. MURPHY PLUMBING CO.,
/s/ By V. L. MURPHY, Principal

GLENS FALLS INDEMNITY COMPANY,
/s/ By LEO G. LEVENS, Attorney

Refer to Performance Bond for charge for both bonds.

Duly Verified.

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 5

[Letterhead of American Seating Company]

QUOTATION

August 22, 1949

To all Contractors: Re: Quality Control Surveillance Laboratory, U. S. Naval Ammunition & Net Depot, Seal Beach, California.

We are pleased to submit herewith our revised quotation on Kewaunee Laboratory Furniture for above project as follows:

Item No. 1—One Center Table approximately 21′0 long, to consist of an enclosed end sink No. S-691-X (12″ deep). The table is to have a 1¼″ thick soapstone top and center trough. There are to be 4 No. S-271 units, 2 No. S-173, 2 No. S-420, 2 No. S-233, and 2 No. S-100. These file units are to be at the extreme end opposite the sink, and are to be next to the S-420 units, which will be 30″ high, forming a desk on either side of the table. The plumbing is to be provided at the sink-end. There shall be a Reagent Rack similar to that shown on Steel Lab Table No. 4450, to have 4 No. S-944 water cocks, 16 No. S-901A gas cocks, 8 No. S-1101A double electric flush receptacles, and 1 No. S-927 hot and cold water goosenecks, with piping in the Reagent Rack only. Sink is to be of soapstone also—$3392.00.

Item No. 2—Two No. S-1817X Units (72″ long). One of them to have 1 No. S-1215-C electric heated water bath, left end of left hood; and these units are to have 1 each of the following: 1 No. S-740 soapstone sink, right end of both hoods; 1 No. S-1106-F quadruple electric, in center rear; 1 No. S-924 remote control water; 1 No. S-904-A remote control gas; 1 No. S-904-A remote control vacuum, with vapor-proof light and switch—$2482.00.

Item No. 3—One No. 60AS Sink with 1 No. W-1446 Birch Pegboard—$482.00.

Total—$6356.00.

The above items will be of standard Kewaunee construction, with standard finish black plastic hardware and chrome-plated fixtures. Piping and

conduit is included in the Reagent Rack of Item No. 1 only. The above prices include delivery and assembly of equipment, but no piping or conduit (except as above mentioned), nor does it include our setting of the fixtures. The above quotation is subject to applicable State or Local taxes, if any. Shipment can be made in approximately 90 days after approval of drawings by customer.

We appreciate the opportunity of submitting this quotation, and trust we may have the pleasure of serving you further.

Yours very truly,

AMERICAN SEATING COMPANY,
Los Angeles Branch
/s/ T. E. DEWEY, Sales Manager

TED:b

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 6

[Letterhead of American Seating Co.]

(Copy) August 23, 1949

V. L. Murphy, Plumbing Contractor
1117 Obispo Avenue, Long Beach, California

Re: Quality Control Surveillance Laboratory
U.S. Naval Ammunition & Net Depot, Seal Beach, California.

Dear Mr. Murphy:

We are enclosing a copy of our revised quotation on equipment for the above-mentioned laboratory.

I am writing this letter as a matter of record, and sending a copy to Mr. Grandy at Laguna, so that he will be acquainted with what has transpired verbally for the last two months.

As you will recall, the original shop drawings of this equipment were rejected by the men in charge of this laboratory as not meeting their requirements. Upon checking both with Mr. Johnson and Mr. Bell at the laboratory, and with Mr. Dudley and Mr. Hall at the Naval Shipyards, we found that the specifications, as written on the plans, were not sufficiently detailed, and did not represent the desired equipment. We revised our drawings to meet the approval of the men in the laboratory. This revision resulted in an increase in cost of this equipment to you of approximately $410.00, which new price is still, I believe, within your budget on this job. It is my understanding that the funds set aside for this building have been entirely budgeted, and there is no remaining cash with which to defray this added expense. If an application is made to the Navy by you for any increase, a change-order would be necessary, and the only thing this change-order could bring about would be the deletion from the contract of the entire laboratory equipment. The funds for this equipment would then be returned to the Bureau of Yards and Docks, and it would, presumably, be some years before this equipment could be purchased. I do not think that you desire such a situation. In way of a return for your fairness in this matter, the contracting agency for the Navy has

agreed to grant us (Kewaunee Manufacturing, American Seating, Murphy and Grandy) a time extension on the contract, since it was a mistake in specifications which caused this delay period. We have been assured by Mr. Dudley and Mr. Williams that this extension of time will be granted when applied for, but at this writing we do not know exactly what extension of time will be necessary. In the middle of September we should be able to know exactly how many days will be necessary for the completion of our part of this contract.

I am also sending you four copies of Kewaunee's latest shop drawings, which drawings have already actually been approved by the Department of Public Works at the Naval Base. However, at the time such approval was secured we had in our possession only two copies of the prints, and "for submission through channels" it is our understanding that six sets are necessary. Hence, our sending these four sets at this date. I presume you will send them on to Mr. Grandy so that he may write a letter of submission accompanying these plans, and send them on to the Navy for their ultimate approval (one approved copy of which we should like to receive).

I hope that this letter has in some way clarified the many questions and explanations that have been made to so many people so many different times, in an effort to happily fulfill the contract. Thank you for your patience, and I trust that the equipment will be produced, delivered and installed without further interruptions. I will contact you in

September, giving you our definite date of delivery on this equipment.

Sincerely yours,

AMERICAN SEATING COMPANY,
Los Angeles Branch
/s/ JOHN D. MULLEN,
Sales Representative

vrl—Encls. Copy to E. F. Grandy, Inc., General Contractors, P.O. Box 401, Laguna Beach, Cal.

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 7

[Letterhead of V. L. Murphy]

PURCHASE ORDER

American Seating Company Sept. 23, 1949
6900 Avalon Blvd., Los Angeles 3, Calif.

To be delivered to: Quality Control Surveillance Laboratory, U. S. Naval Ammunition & Net Depot, Seal Beach, Calif.

Item No. 1—One Center Table approximately 21'0" long, to consist of an enclosed end sink No. S-691-X (12" deep). The table is to have a 1¼" thick soapstone top and center trough. There are to be 4 No. S-271 units, 2 No. S-173, 2 No. S-420, 2 No. S-233, and 2 No. S-100. These file units are to be at the extreme end opposite the sink, and are to be next to the S-420 units, which will be 30" high, forming a desk on either side of the table. The plumbing is to be provided at the sink end. There

shall be a Reagent Rack similar to that shown on Steel Lab Table No. 4450, to have 4 No. S-944 water cocks, 16 No. S-901A gas cocks, 8 No. S-1101A double electric flush receptacles, and 1 No. S-927 hot and cold water goosenecks, with piping in the Reagent Rack only. Sink is to be of soapstone also.—$3392.00.

Item No. 2—Two No. S-1817X Units (72" long). One of them to have 1 No. S-1215-C electric heated water bath, left end of left hood; and these units are to have 1 each of the following: 1 No. S-740 soapstone sink, right end of both hoods; 1 No. S-1106-F quadruple electric, in center rear; 1 No. S-924 remote control water; 1 No. S-904-A remote control gas; 1 No. S-904-A remote control vacuum, with vapor-proof light and switch—$2482.00.

Item No. 3—One No. 60AS Sink with 1 No. W-1446 Birch Pegboard—$482.00.

The above items will be of standard Kewaunee construction, with standard finish black plastic hardware and chrome-plated fixtures. Piping and conduit is included in the Reagent Rack of Item No. 1 only. The above prices include delivery and assembly of equipment, but no piping or conduit (except as above mentioned), nor does it include our setting of the fixtures. The above quotation is subject to applicable State or Local taxes, if any. Shipment can be made in approximately 90 days after approval of drawings by customer.

V. L. MURPHY PLUMBING,
/s/ V. L. MURPHY

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 8

efg:h September 26, 1949

To: Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, U. S. Naval Receiving Station, Long Beach 2, California.

Subject: Contract NOy-16752, Specification No. 20656, Conversion of Building Is-16 to Quality Control Surveillance Laboratory at the U. S. Naval Ammunition and Net Depot, Seal Beach, California.

1. Enclosed herewith four (4) copies Purchase Order from V. L. Murphy, plumbing sub-contractor, to American Seating Company, agents for Kewaunee Manufacturing Company for chemical laboratory equipment presently being manufactured at Adrian, Michigan.

2. It is requested that the Officer-in-Charge of Construction do everything possible to expedite factory inspection in order that, immediately upon completion, this equipment may be forwarded for installation.

E. F. GRANDY, INC.

encl. By .....

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 9

[Letterhead of American Seating Company]

Mr. E. F. Grandy December 20, 1949
P.O. Box 401, Laguna Beach, California

Re: Laboratory Furniture, Quality Control Surveillance Laboratory, U. S. Naval Ammunition & Net Depot, Seal Beach, California.

Dear Sir:

The delivery and installation of laboratory equipment for the above reference laboratory, has been completed except for three items to be corrected.

These three items are the correction of the steam bath to agree with the features detailed on the approved drawing, correct size sink, and replacement of two cracked safety-glass in the fume hood.

The necessary materials are being obtained and the corrections will be made at the Laboratory without additional charge to the contractor or to the U. S. Government. On all three items there are temporary materials in place which will allow the use of this equipment.

Very truly yours,

AMERICAN SEATING COMPANY,
Los Angeles Branch
/s/ E. D. THOMPSON, Office Manager

vrl

Marked for identification April 1, 1953.

PLAINTIFF'S EXHIBIT No. 10

efg:h December 22, 1949

To: Officer-in-Charge of Construction, U. S. Naval Base Los Angeles, U. S. Naval Receiving Station, Long Beach 2, California.

Attention: Mr. E. L. Williams, Contract Superintendent.

Subject: Contract NOy-16752, Spec. 20656, Conversion of Building IS-16 to Quality Control Surveillance Laboratory at the U. S. Naval Ammunition & Net Depot, Seal Beach, California. Laboratory Furniture.

1. Enclosed herewith three copies correspondence received from American Seating Company relative to laboratory furniture manufactured by Kewaunee Company, outlining corrections and/or revisions to be completed in the laboratory installation.

E. F. GRANDY, INC.

encl. By .....

Marked for identification April 1, 1953.

PLAINTIFF'S EXHIBIT No. 11

American Seating Company January 6, 1950
6900 Avalon Blvd., Los Angeles 3, California

Attention: Mr. T. E. Dewey.

Dear Sir:

Enclosed herewith copy of letter received from the Officer-in-Charge of Construction, U. S. Naval

Base Los Angeles, relative to noncompliance with specification requirements.

You are, no doubt, aware that the above mentioned noncompliance constitutes a very effective block to receipt of funds for work already performed on the contract at Seal Beach.

In view of this condition, it is requested that your firm make all possible effort to comply with the required work outlined in the enclosed letter.

Yours very truly,

E. F. GRANDY, INC.

efg:h—encl.

By .....

Marked for identification April 1, 1953.

PLAINTIFF'S EXHIBIT No. 12

Registered—Return Receipt Requested.

December 1, 1950

Glens Falls Indemnity Company
548 South Spring Street
Los Angeles 13, California

Attention: Surety Department.
Re: Payment Bond No. 427357, V. L. Murphy, 1117 Obispo Avenue, Long Beach, Calif.

Gentlemen:

We are writing with reference to a contract entered into between American Seating Company and V. L. Murphy, on which E. F. Grandy, Laguna Beach, California, was the general contractor, for

the United States Navy, Quality Control Surveillance Laboratory, Seal Beach, California.

Mr. Murphy has outstanding with us, under the contract, the sum of $6,124.37, per the attached invoice. This amount is greatly overdue, and Mr. Murphy has given us a number of reasons why payment is delayed—among them that he had not received payment from Mr. Grandy, the general contractor. Upon contacting Mr. Grandy directly we were informed that Mr. Grandy has paid Mr. Murphy in full. Since receiving this information from Mr. Grandy, Mr. Murphy admitted that he had been paid.

Under the circumstances, inasmuch as Mr. Murphy has failed to remit to us the amount due us, we have no alternative but to make formal demand for payment in full under the above Payment Bond No. 427357. Please let us know when we may expect to receive payment in full.

Very truly yours,

AMERICAN SEATING COMPANY,
Los Angeles Branch
vrl GEORGE W. PETERSON, Manager

Copy to: Mr. V. L. Murphy, 1117 Obispo Ave., Long Beach, Cal. B/cc: E. L. Grandy, E. F. Grandy, Inc., P.O. Box 401, Laguna Beach, Calif.; Mrs. Eva L. Cole, Cole Insurance Agency, Inc., 548 So. Spring St., Los Angeles 13, Calif.; Miss Ruth Casalini, San Francisco Office.

P.O. Return Receipts attached.

[American Seating Company Invoice]

No. 58706 OR/CO Date: 3-15-50

Sold to: V. L. Murphy, Plumbing & Heating, Mr. V. L. Murphy, Box 214A, Route 1, Anaheim, California.

Ship to: Quality Control Surveillance Laboratory, U. S. Naval Ammunition and Net Depot, Seal Beach, California.

Date Entered: 6-27-49; Ship when: S.A.P.; Routing: Best way ppd; F.O.B.: Dest set up (not connected); Salesman: Mullen; Cust. No. 179. Terms: Net 30 days from date of invoice.

Quantity Shipped	Amount
1 Only—Fume Hood—Item No. 1	
1 Only—Center Table—Item No. 2	
1 Only—Sink—Item No. 3	
All above delivered and assembled (not including piping or conduit nor setting of fixtures) in Quality Control Surveillance Laboratory, U. S. Naval Ammunition and Net Depot, Seal Beach, Calif., per our quotation dated April 7, 1949, for the total sum of....	$5,945.99
(All applicable taxes to be added)	
3% State Sales Tax.....	178.38
	$6,124.37

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 13

[Letterhead of Glens Falls Indemnity Co.]

American Seating Company, Jan. 3, 1951
6900 Avalon Blvd., Los Angeles 3, California.

Re: Bond No. 427357, V. L. Murphy Plumbing Co., Prin.; E. F. Grandy, Inc. Obligee.

Attention: George W. Peterson, Manager.

Gentlemen:

In response to your letter of December 22nd, 1950, may we advise that Mr. Murphy discussed the matter of his unpaid account with this office and stated at that time that stated claim was not to be considered as a default under the bond but was instead a matter which he would take up with your firm. Under the circumstances, we have no alternative other than to accede to Mr. Murphy's request.

Yours very truly,

CLAIM DEPARTMENT
/s/ By ROY O. SAMSON

ROS:pr

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 14

E. F. Grandy, Inc. May 23, 1949
P.O. Box 401, Laguna Beach, California.

Gentlemen:

This is to advise you that I have given a full and complete assignment of our Sub-Contract dated

May 4, 1949, under Project No. NOy-16752, to the Farmers and Merchants Bank of Long Beach.

You are hereby authorized and instructed to forward the proceeds due me under the above Sub-Contract direct to the Farmers and Merchants Bank of Long Beach, 302 Pine Avenue, Long Beach, California, attention J. B. Ivey, Vice President.

Kindly acknowledge receipt of this assignment direct to the bank.

Very truly yours,

mh /s/ V. L. MURPHY

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 15

[Letterhead of Farmers & Merchants Bank]

E. F. Grandy, Inc. May 23, 1949
P.O. Box 401, Laguna Beach, California.

Gentlemen:

We are enclosing a letter signed by V. L. Murphy authorizing you to forward the proceeds due him under your Sub-Contract dated May 4, 1949, direct to this bank.

Kindly acknowledge receipt of this assignment by signing and returning to us the attached copy of this letter.

Very truly yours,

J. B. IVEY, Vice President

We herewith acknowledge receipt of assignment of V. L. Murphy's Sub-Contract, dated May 4, 1949, for Plumbing and Piping, under our prime Contract NOy-16752 for Conversion of Building IS-16 to Quality Control Surveillance Laboratory at the U. S. Naval Ammunition & Net Depot, Seal Beach, California, subject to such revisions as may be required during construction.

All payments due under above described Sub-Contract will be made direct to the Farmers and Merchants Bank of Long Beach, 302 Pine Avenue, Long Beach, California, attention J. B. Ivey, Vice President.

Dated: 25 May 1949.

E. F. GRANDY, INC.,
/s/ By E. F. GRANDY

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 16

ASSIGNMENT

For Value Received, I, the undersigned, hereby sell, assign and transfer to the Farmers and Merchants Bank of Long Beach, 302 Pine Avenue, Long Beach, California, all my right, title, interest and demand in all monies due or to become due, when and as the said monies shall have accrued pursuant to the terms of Sub-Contract dated May 4, 1949, by and between V. L. Murphy and E. F. Grandy, Inc., covering Plumbing and Piping per

Section 17, Spec. 20656, Y & D Drawings No. 417042 thru 417055, with full authority to collect and receipt for the same.

Dated at Long Beach, California, this 23rd day of May, 1949.

/s/ V. L. MURPHY

Subscribed and sworn to before me this 23rd day of May, 1949.

[Seal] /s/ MARYALYS HELFRICH,
Notary Public in and for County of Los Angeles, State of California.

Admitted in Evidence May 8, 1953.

PLAINTIFF'S EXHIBIT No. 17

[Letterhead of John E. McCall]

Wolfson & Essey January 22, 1953
Attorneys at Law
121 S. Beverly Drive, Beverly Hills, Calif.

Atten: Mr. Irving H. Green.
Re: American Seating Company vs. Glens Falls Indemnity Co., et al.

Gentlemen:

I sent a copy of your letter of December, 1952 to Mr. Grandy and after he had received from you his file, he called and gave me the following information regarding the questions raised in your letter:

The answer to Interrogatory No. 4 contained a typographical error wherein the amount was shown as $61.37 at line 12 and should have been $6,356.

Re Interrogatory No. 7: Any change in this answer by Mr. Grandy would be hearsay.

Re Interrogatory No. 8: The file which you sent back to Mr. Grandy contains a copy of said Purchase Order, so Mr. Grandy's answer to Interrogatory No. 8 should be changed to show that the file you returned to him did have a copy of the Purchase Order in it.

Re Interrogatory No. 10: The date of the payment to the Farmers & Merchants Bank of Long Beach under the assignment by V. L. Murphy was in the file which Mr. Grandy loaned you for use in your suit against Murphy.

Re Interrogatory No. 12: According to the records Mr. Grandy has, the work was completed about June. If the exact date is shown in the records loaned you by Mr. Grandy, we can use the information you have. Work of this kind is never paid for until it is completed or until the material is on the site.

Re Interrogatory No. 20: The original answer is correct; your conclusion is incorrect.

Re Interrogatory No. 24: The original answer is correct.

Interrogatory No. 31: You state this answer is not complete. Mr. Grandy and I know of nothing to be added to the original answer, but if anything is lacking, it is supplied by answer to Interrogatory 32.

I understand you want this additional information to assist you in preparing a proposed Statement of Facts. While I cannot see how anything mentioned in the Interrogatories could become a part of the Statement of Facts, except the amount involved, I shall be glad to review any statement which you may prepare, with the idea of agreeing on a Statement of Facts which may be submitted to the Court with a brief of the legal points.

Yours very truly,

/s/ J. E. McCALL

JEM/gb

Admitted in Evidence May 8, 1953.

DEFENDANTS' EXHIBIT "A"

[Letterhead of American Seating Company]

Glen Falls Indemnity Company Dec. 22, 1950
548 S. Spring St., Los Angeles 13, Calif.

Att.: Surety Department, Mr. Sampson, Claims Dept.

Re: Repayment Bond No. 427357, V. L. Murphy, 1117 Obispo Ave., Long Beach, Calif.

Dear Mr. Sampson:

Miss Blunt of this office, has called your office in reference to the bond that you issued to the above party. Our letter of December 1st explained the conditions involved as to Mr. Murphy not paying his account, and you gave several reasons why you

would not take over the responsibility of either paying or forcing the payment at this time.

We desire very much to have a letter from you giving the reasons that you gave us over the phone. Frankly, we intend to start proceedings very shortly, and bring this matter to a conclusion. We see no reason why you should be reluctant to give us a letter confirming your statements to us, as it is in accordance with the policy of your Company.

Will you kindly let us have this letter the early part of this coming week. In fact we need it by December 27th at the latest. Your attention to this matter will be very much appreciated.

Very truly yours,

AMERICAN SEATING COMPANY,
Los Angeles Branch
vrl /s/ GEORGE W. PETERSON, Manager

Admitted in Evidence May 8, 1953.

DEFENDANTS' EXHIBIT "B"

[Exhibit "B" is a Government Construction Contract which is too lengthy to be printed and for this reason may be referred to in its original form, if required.]

Admitted in Evidence May 8, 1953.

DEFENDANTS' EXHIBIT "C"

[Letterhead of Wolfson & Essey]

John E. McCall, Esq. Dec. 19, 1952
Attorney-at-Law
458 S. Spring St., Los Angeles, Calif.

In re: American Seating Company vs. Glens Falls Indemnity Company, et al.

Dear Mr. McCall:

Pursuant to our telephone conversation concerning this matter today, I am writing to ask you to clarify the answers to the Interrogatories submitted to E. F. Grandy.

The answer to Interrogatory 4 is apparently erroneous. Will you please correct that.

With reference to the answer to Interrogatory 7, we are advised that Grandy was furnished a copy of the purchase order for this material and does know the agreed price at which American Seating Company furnished these materials and supplies on this job. Please have him correct the answer to this Interrogatory.

With reference to Interrogatory 8, the file that we sent back to American Seating Company will show that they did receive a copy of this purchase order. This answer should be corrected. The same applies to Interrogatory 9 and the answer thereto.

In answer to Interrogatory 10, Mr. Grandy did not say the date on which he made payment and this was requested in the Interrogatory.

Grandy knows the answer to Interrogatory 12. We are not concerned with the exact date when

Murphy completed the work but only with the fact that the materials supplied by American Seating Company were installed before Murphy was paid.

I believe that the answer to Interrogatory 20 is incorrect since contractors are required to certify to payment.

The answer to Interrogatory 24 is not complete.

The answer to Interrogatory 31 is not complete.

It is my belief that if the answers to these Interrogatories are corrected properly, it will not be necessary to take the deposition of Mr. Grandy.

Your prompt attention to this matter will be appreciated.

Very truly yours,

WOLFSON & ESSEY,
/s/ By IRVING H. GREEN

IHG-N

Admitted in Evidence May 8, 1953.

[Endorsed]: No. 14258. United States Court of Appeals for the Ninth Circuit. Glens Falls Indemnity Company, a Corporation, and E. F. Grandy, Inc., Appellants, vs. American Seating Company, a Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Southern District of California, Central Division.

Filed: March 3, 1954.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 14,258

GLENS FALLS INDEMNITY COMPANY, a New York Corporation, and E. F. GRANDY, INC., a California corporation,

Appellants,

vs.

AMERICAN SEATING COMPANY, a New Jersey corporation, Appellee.

POINTS ON WHICH APPELLANTS INTEND TO RELY ON APPEAL

Pursuant to Rules of the United States Court of Appeals for the Ninth Circuit, Rule 17, Appellants herein make a concise statement of the points on which Appellants intend to rely and designate the record which is material to the consideration of the appeal.

1. Judgment against Appellant Glens Falls Indemnity Company and E. F. Grandy, Inc., or either of them, cannot be predicated upon the common law performance bond.

(A) The performance bond here involved is a common law indemnity bond as distinguished from a bond required by statute, and it was furnished to the obligee, Appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned upon the perform-

ance of the subcontract by V. L. Murphy. There is no allegation in the complaint, no evidence was introduced and no Finding of Fact was made to the effect that the obligation of said bond was in full force and virtue at the time of the institution of this action. Therefore, Conclusion of Law I, concluding that Appellee is entitled to recover against Appellants, is reversible error because said Conclusion and the Judgment are not supported by the pleadings, the evidence or the Findings insofar as said Conclusion and Judgment may be based upon the performance bond.

(B) The performance bond cannot be the basis for Judgment against Appellant E. F. Grandy, Inc. for the further reason that said E. F. Grandy, Inc. was the obligee thereunder and as such is the person for whose benefit and protection the bond was written and pursuant to which no liability whatsoever was created against or assumed by the obligee, E. F. Grandy, Inc. Conclusion of Law I and the Judgment against Appellant E. F. Grandy, Inc., are erroneous because they are against the law insofar as they may be predicated upon the said bond. There is no evidence and no Finding of Fact and no Conclusion of Law to the effect that said bond conferred, created or gave rise to any liability, claim or cause of action or right of any kind against Appellant E. F. Grandy, Inc., the obligee, and the Judgment is therefore unsupported by the evidence, the Findings of Fact and the Conclusions of Law and the court erred in granting the same insofar as it may be predicated on said bond.

(C) The performance bond is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, Appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them for the sole purpose of, and restricted by its terms to, indemnifying the contractor, Appellant E. F. Grandy, Inc., against the failure of the subcontractor to fully perform the subcontract. To predicate judgment upon the performance bond against the surety, Appellant Glens Falls Indemnity Company, the trial court must affirmatively find that the subcontractor failed to perform the subcontract and that Appellant E. F. Grandy, Inc., has been damaged thereby. It was reversible error for the trial court to grant Judgment against Appellant Glens Falls Indemnity Company because there is no evidence to support a Finding that Appellant E. F. Grandy, Inc., was damaged by failure of the subcontractor to perform the subcontract and none was made and Conclusion of Law I is therefore unsupported by the Findings of Fact insofar as said Conclusion of Law is based upon the performance bond.

(D) As a matter of law, a common law indemnity bond such as the performance bond here involved does not confer, create or give rise to any liability, claim or cause of action or right of any kind in favor of third parties and therefore, insofar as Conclusion of Law I and the Judgment for Appellee against Appellants, or either of them, as

surety and obligee, respectively, are based upon any rights supposedly created by the terms and provisions of this bond, the said Conclusion of Law and the Judgment are erroneous because they are against the law.

(E) Finding of Fact 6 that the performance bond was written "in part for the protection of plaintiff to the extent of plaintiff's claim" and "that there existed a contractual relationship relating to said Performance Bond * * * between plaintiff and the defendants * * * and each of them" is wholly unsupported by the evidence and therefore erroneous. The trial court committed reversible error insofar as said Finding may be a Conclusion of Law. because it is unsupported by the Findings of Fact and the evidence and therefore does not support Conclusion of Law I or the Judgment against Appellants, or either of them.

2. Judgment against Appellants Glens Falls Indemnity Company and E. F. Grandy, Inc., or either of them, cannot be predicated upon the common law payment bond.

(A) The payment bond here involved is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, Appellant E. F. Grandy, Inc. contractor by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned to indemnify said Appellant obligee against loss resulting to said Appellant obligee by reason of the relationship of contractor and subcontractor. Appellant E. F.

Grandy, Inc. was the person for whose benefit and protection the bond was written and pursuant to which no liability whatsoever was created against or assumed by the obligee, E. F. Grandy, Inc. Conclusion of Law I and the Judgment against said Appellant are erroneous because they are against the law insofar as they may be predicated upon the said bond. There is no evidence and no Finding of Fact and no Conclusion of Law to the effect that said bond conferred, created or gave rise to any liability, claim or cause of action or right of any kind against Appellant E. F. Grandy, Inc., the obligee, and the Judgment is therefore unsupported by the evidence, the Findings of Fact and the Conclusions of Law and the court erred in granting the same insofar as it may be predicated on said bond.

(B) The payment bond here involved is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, Appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned to indemnify said Appellant obligee against loss resulting to said Appellant obligee by reason of the relationship of contractor and subcontractor. To predicate Judgment upon this payment bond against the surety Glens Falls Indemnity Company, the trial court must affirmatively find that Appellant E. F. Grandy, Inc. has suffered such loss. There is no evidence in the record and no Finding of Fact or Conclusion of Law

to the effect that the claim of Appellee against Appellant E. F. Grandy, Inc. arose by reason of the relationship of contractor-subcontractor existing between Appellants and resulted in a loss to Appellant E. F. Grandy, Inc., and Conclusion of Law I is therefore unsupported by the evidence and the Findings of Fact; and the court committed reversible error in granting Judgment against Appellant Glens Falls Indemnity Company.

(C) As a matter of law, a common law indemnity bond such as the payment bond here involved does not confer, create or give rise to any liability, claim or cause of action or right of any kind in favor of third parties and therefore insofar as Conclusion of Law I and the Judgment for Appellee against Appellants, or either of them, as surety and obligee, respectively, are based upon any rights supposedly created by the terms and provisions of this payment bond, the said Conclusion of Law and Judgment are erroneous because they are against the law.

(D) Finding of Fact 6 that the performance bond was written "in part for the protection of plaintiff to the extent of plaintiff's claim" and "that there existed a contractual relationship relating to said * * * Payment Bond between plaintiff and the defendants * * * and each of them" is wholly unsupported by the evidence and therefore erroneous. The trial court committed reversible error insofar as said Finding may be a Conclusion of Law because it is unsupported by the Findings of Fact and the evidence and therefore does not support

Conclusion of Law I or the Judgment against Appellants, or either of them.

3. Judgment against Appellant Glens Falls Indemnity Company cannot be predicated upon a contractual relationship between Appellee American Seating Company and Appellant Glens Falls Indemnity Company.

There is no allegation in the complaint of either an express or implied contract between Appellee and Appellant Glens Falls Indemnity Company, no evidence thereof was introduced, and Finding of Fact 6 is inadequate in this respect. Conclusion of Law I and the Judgment are therefore unsupported by the evidence and the Findings and the trial court erred insofar as the Conclusions of Law and the Judgment may be based upon an express or implied contract between said parties.

4. Judgment against Appellant Glens Falls Indemnity Company cannot be predicated upon a contractual relationship between Appellee American Seating Company and Appellant E. F. Grandy, Inc.

The performance bond and the payment bond of Appellant Glens Falls Indemnity Company related exclusively to the subcontract between V. L. Murphy, the subcontractor, and E. F. Grandy, Inc., the contractor. Any direct contractual relationship whether arising by express agreement or by implication of law between Appellee and E. F. Grandy, Inc., would be outside the scope of either of said bonds. The trial court erred in granting Judgment against Appellant Glens Falls Indemnity Company insofar as such Judgment may be based

upon a contract between Appellee and Appellant E. F. Grandy, Inc., because such a contract is outside the scope of the said bonds since it is not the contract with respect to which the contract of indemnity was furnished and Conclusion of Law I and the Judgment are unsupported by the Findings of Fact in this respect.

5. Judgment against Appellant E. F. Grandy, Inc. cannot be predicated upon a contractural relationship between Appellee and Appellant E. F. Grandy, Inc.

There is no allegation in the complaint of either an express or implied contract between Appellee and Appellant E. F. Grandy, Inc. and no evidence thereof was introduced and Finding of Fact 6 is inadequate in this respect, and Finding of Fact 7 reciting that Appellant E. F. Grandy, Inc. approved the contract between Appellee and V. L. Murphy is unsupported by the evidence. Conclusion of Law I and the Judgment are therefore unsupported by the evidence and the Findings and the trial court erred insofar as the Conclusions of Law and the Judgment may be based upon an express or implied contract between said parties.

6. The Findings of Fact and Conclusions of Law are vague and indefinite and inadequate to disclose the factual or legal basis for the Judgment and are inherently inconsistent because they cannot be interpreted in any manner which would result in joint legal liability of Appellants.

Liability must be predicated upon the bonds or either of them or upon the existence of an express

or implied contract between Appellee and Appellants or either of them. Under the first alternative Appellant E. F. Grandy, Inc. could not be liable because as already noted in points 1B and 2A said Appellant was the obligee and as such the party to be protected. The bonds created no right in favor of any party against said obligee. Under the second alternative, each party would be liable for his own contract with Appellee and such a contract was not the subject matter of either bond and outside of the scope thereof and therefore not affected by the provisions of either of said bonds in any manner. As above pointed out, neither party was obligated to Appellee by direct contract either express or implied, but any such contract could affect the contracting party only.

7. The Trial Court erred in granting judgment for interest from June 1, 1949, to date of Judgment.

Finding of Fact 7 to the effect that on the 1st day of June, 1949, Appellee furnished the goods referred to in the complaint and Finding of Fact 9 that the sum mentioned therein was due and owing to Appellee from Appellants from and after the 1st day of June, 1949, are both entirely unsupported by the evidence. It was error for the court to so find and to adopt Conclusion of Law I and grant Judgment both based upon said Findings.

8. The Findings are unsupported by the evidence in the following additional material respects:

(A) Finding of Fact 6 is unsupported by the evidence to the extent that it is therein found that Appellants, or either of them, knew that in order

for the subcontractor "V. L. Murphy to carry out his contract, it would be necessary for him to purchase and obtain supplies from plaintiff."

(B) Finding of Fact 8 is unsupported by the evidence.

(C) Finding of Fact 10 is in error in the following material respects: In every respect wherein it is hereinabove alleged that the Findings are not supported by the evidence the court further erred by not affirmatively finding that the contrary is true since in each instance the correlative allegation of the complaint was denied in the respective answers and Appellee had the burden of proof.

* * * * *

Dated: March 8, 1954.

Respectfully submitted,

McCALL & McCALL and
ALBERT LEE STEPHENS, JR.,
/s/ By ALBERT LEE STEPHENS, JR.,
Attorneys for Appellants

Affidavit of Service by Mail attached.

[Endorsed]: Filed Mar. 9, 1954. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION RE PRINTING OF EXHIBITS AND ORDER

Whereas, Appellants, by and through their counsel of record, presented to the United States Court

of Appeals for the Ninth Circuit a Motion to Clarify Record on Appeal, which said motion came on regularly for hearing pursuant to due and proper notice thereof on the 5th day of April, 1954; and

Whereas, at the said time and place Appellee, by and through its counsel of record, presented to the United States Court of Appeals an Order Ex Parte Nunc Pro Tunc, copy of which is attached hereto and made a part hereof by reference, which said order was signed on the 5th day of April, 1954; and

Whereas, the Court, consisting of the Honorable Clifton Mathews, Judge presiding, the Honorable Albert Lee Stephens, present but not participating, and the Honorable Homer T. Bone, suggested that the motion be dismissed with the understanding that the exhibits referred to in the said motion and the said Order Ex Parte Nunc Pro Tunc would be considered as properly admitted in the United States District Court for all purposes of the appeal since the Honorable Ernest A. Tolin, District Judge, stated that it was an inadvertence that said exhibits were not received in evidence, although he had intended to receive the same; and

Whereas, the Court expressed a desire to refer to said exhibits in printed form rather than in their original form, if they were not lengthy;

Now, Therefore, It Is Hereby Stipulated, in compliance with the suggestions of the Court, by and between Appellants and Appellee, by and through their respective counsel of record, that an order

may be made that the following exhibits be printed in the record:

Exhibits 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12 consisting of a one-page letter and attached invoice, 13, 14, 15, 16, 17, Exhibits A and C, and that the record should show in the appropriate place that Exhibit B is a Government construction contract which is too lengthy to be printed and that for this reason the same may be referred to in its original form, if required.

Dated: April 6, 1954.

McCALL & McCALL and
ALBERT LEE STEPHENS, JR.
/s/ By ALBERT LEE STEPHENS, JR.,
Attorneys for Appellants

WOLFSON & ESSEY and
IRVING H. GREEN,
/s/ By IRVING H. GREEN,
Attorneys for Appellee

ORDER

It is so ordered.

Dated: April 14, 1954.

/s/ CLIFTON MATHEWS,
/s/ HOMER T. BONE,
Judges, U. S. Court of Appeals for the Ninth Circuit

ORDER EX PARTE NUNC PRO TUNC

Good cause appearing therefor;

It Is Hereby Ordered, Adjudged and Decreed that, plaintiff's Exhibits 1, 9, 10 and 11, marked for identification, and each of them, be and the same hereby are received in evidence nunc pro tunc as of June 1, 1953.

Dated this 1st day of June, 1953.

ERNEST A. TOLIN,
Judge of the District Court

This order signed this 5th day of April, 1954 nunc pro tunc June 1, 1953, for the reason that by inadvertence the exhibits were not received in evidence. The Court mis-remembered the events at trial and failed to rule as it intended to do, that the exhibits be received.

ERNEST A. TOLIN, Judge

[Endorsed]: Filed Apr. 15, 1954. Paul P. O'Brien, Clerk.

No. 14258.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GLENS FALLS INDEMNITY COMPANY, a New York corporation, and E. F. GRANDY, INC., a California corporation,

Appellants,

vs.

AMERICAN SEATING COMPANY, a New Jersey corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

McCALL & McCALL and
ALBERT LEE STEPHENS, JR.,
By ALBERT LEE STEPHENS, JR.,
458 South Spring Street,
Los Angeles 13, California,
Attorneys for Appellants.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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TABLE OF AUTHORITIES CITED

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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GLENS FALLS INDEMNITY COMPANY, a New York corporation, and E. F. GRANDY, INC., a California corporation,

Appellants,

vs.

AMERICAN SEATING COMPANY, a New Jersey corporation,

Appellee.

APPELLANTS' OPENING BRIEF.

I.

Statement of the Pleadings and Facts Disclosing Jurisdiction.

Pleadings consist of the Complaint, the Answer of Glens Falls Indemnity Company and the Answer of Defendant E. F. Grandy, Inc. Jurisdiction is based upon diversity of citizenship. Plaintiff American Seating Company is a New Jersey corporation, defendant Glens Falls Indemnity Company is a New York corporation and defendant E. F. Grandy, Inc., is a California corporation [R. 3]. The Farmers and Merchants Bank of Long Beach, which is also a defendant, but not an appellant, is a California corporation [R. 4].

The amount in controversy exceeds the sum of $3,000.00, exclusive of interest and costs, to wit, the sum of $6,124.37 [R. 9]. Jurisdiction of the District Court of the United States is authorized by Title 28, U. S. C., Section 1332. Jurisdiction of the United States Court of Appeals is based upon Title 28, U. S. C., Section 1291.

II.

The Nature of the Proceedings in the Trial Court.

For convenience appellant Glens Falls Indemnity Company, a corporation, one of the defendants in the trial court, will be referred to as Glens Falls, and appellant E. F. Grandy, Inc., a corporation, one of the defendants in the trial court, will be referred to as Grandy, Inc. The Farmers and Merchants Bank of Long Beach was also a defendant in the trial court, but trial as to this defendant was deferred pending judgment as to the other parties [R. 33, 99]. Appellee American Seating Company, a corporation, was plaintiff in the trial court.

On April 1, 1953, at the pre-trial conference, the parties filed pre-trial briefs, each of which contained a statement of facts. Counsel for appellants Glens Falls and Grandy, Inc., objected to including conclusions in the statement of facts contained in the pre-trial brief of plaintiff and appellee American Seating Company. Rather than debate the specific wording of his statement of facts, counsel for American Seating Company undertook to orally make a statement of facts and to introduce exhibits for identification. For this reason the statement of facts contained in the pre-trial brief of plaintiff American Seating Company has not been included in the printed transcript, while those of the defendants have been included [R. 28, 30].

The statement of facts of Glens Falls and Grandy, Inc., was amended [R. 95] by deleting the following words, commencing in the second line on page 31 of the record:

> "to protect it, E. F. Grandy, Inc., in the event it suffered a loss by reason of the subcontract,"

and by substituting the figures "16,667.05" for the words "in full" appearing at line 12 of page 31 of the record. The statement as amended was conceded to be correct [R. 96]. These amendments were made to avoid conclusions, but the contentions of the appellants are unchanged by the amendments.

The evidence includes the oral statement of facts of counsel for American Seating Company and the written statement of the other parties, the admissions and answers to interrogatories [R. 108], and the exhibits. All of the exhibits are printed in the record except Exhibit B, which is a Government construction contract too lengthy to be printed.

While counsel for appellee was making his statement of facts there was some discussion concerning whether or not there was a telephone call from a representative of appellee to a representative of appellant Glens Falls on or about December 1, 1950 [R. 86, 90], but any issue with respect to this telephone call was withdrawn [R. 105].

The transcript of the proceedings at the pre-trial conference which took place on April 1, 1953, was a transcript consisting principally of the opening statement of counsel for American Seating Company and identification of exhibits and objections to the introduction thereof. The case was then set for trial on May 8, 1953, at which time it was contemplated that the case would be argued after

objections to introduction of exhibits had been settled. On May 8, 1953, certain corrections were made in some of the answers to interrogatories, some of the objections to introduction of exhibits were ruled upon and additional exhibits were admitted while the objections to the introduction of other exhibits were taken under submission.

There was no ruling upon objections taken under submission until after appellants had moved in this court to clarify the record on appeal by striking from the record Exhibits 1, 9, 10 and 11, which had been admitted for identification only. On the date of the hearing of said motion before the United States Court of Appeals on the 5th day of April, 1954, counsel for American Seating Company presented an Order Ex Parte Nunc Pro Tunc to June 1, 1953, receiving said exhibits in evidence, appended to which order was a statement reciting that it was an inadvertence that said exhibits had not been received in evidence. It was thereupon stipulated that the trial court had overruled objections to the admission of any of the exhibits originally offered for identification.

At the trial on May 8, 1953, no witnesses were sworn and no oral testimony was taken. But after the matter of introduction of exhibits and other incidental matters had been concluded, counsel for American Seating Company made a brief argument and the court ordered the case submitted upon briefs to be filed.

III.

Statement of Facts.

On or about the 29th day of April, 1949, defendant E. F. Grandy, Inc., as prime contractor, entered into a written contract in the sum of $100,315.00 with the United States Government for the construction of certain work at the United States Naval Ammunition and Net Depot at Seal Beach, California, and posted with the United States Government a performance bond and a labor and materials bond, as required by the Miller Act, 40 U. S. C. A. 270a and 270b [R. 30]. By an instrument dated the 4th day of May, 1949, defendant Grandy, Inc., entered into a written subcontract in the sum of $16,667.05 with one V. L. Murphy, a plumbing contractor, to do a portion of the work required by the prime contract with the United States Government [R. 147].

On May 12, 1949, Grandy, Inc. replied [by Ex. 1, R. 146] to a letter (which is not in evidence) from its subcontractor, V. L. Murphy. This letter explained the position of Grandy, Inc., relative to "demand payments" to its subcontractors and suggested a way for V. L. Murphy to obtain additional operating capital if such was required. Quoting Exhibit 1 [R. 147]:

> "I might recommend, should additional operating capital be required, that this sub-contract may be assigned to the Bank with whom you are regularly depositing."

It is apparent from the foregoing that prior to May 12, 1949, the subcontract, as it appears in the record, had not

been completely filled out. It would appear that the clause referred to in the letter of May 12 as added is the paragraph appearing in the record as the last paragraph on page 148 of the record. The reason for the subcontractor's inquiry and the contractor's suggestion relative to financing is apparent from the fact that only a few days later, on May 23, 1949, V. L. Murphy was indebted to The Farmers and Merchants Bank of Long Beach for loans and advances in the amount of $10,000.00 and needed further loans [R. 29].

The subcontract was not complete in another respect. It provided that the subcontractor, at his expense, should furnish "a performance or completion bond" with sureties satisfactory to the subcontractor [R. 150]. Performance of this requirement varied somewhat from the precise requirement of the contract in that the contractor and the subcontractor agreed that the subcontractor, V. L. Murphy, would furnish a performance bond in the sum of $16,667.05, and also a payment bond in the principal sum of one-half or $8,333.58 [R. 72-73]. Pursuant to this agreement, both of these bonds were furnished and accepted on May 18, 1949, with appellant Glens Falls as surety [Ex. 3, R. 153; Ex. 4, R. 155].

On May 23, 1949, the subcontractor acted upon the suggestion of the contractor relative to financing. He assigned the subcontract to The Farmers and Merchants Bank of Long Beach [Ex. 16, R. 171]. The contractor, Grandy, Inc., consented in writing to the assignment on

the same day [Ex. 15, R. 170; see also Interrogatory 33, R. 23]. At the time of this assignment, V. L. Murphy was indebted to The Farmers and Merchants Bank of Long Beach for loans and advances in the sum of $10,000.00 and thereafter the bank loaned V. L. Murphy in excess of $46,000.00 [R. 29].

American Seating Company addressed a letter [Ex. 6, R. 158], dated August 23, 1949, to V. L. Murphy, plumbing contractor, and sent a copy of it to Mr. Grandy, who was president of Grandy, Inc., the prime contractor. American Seating Company's purpose in sending this copy to Mr. Grandy is expressed in the first paragraph of the letter in these words:

> "so that he will be acquainted with what has transpired verbally for the last two months."

This letter bears a stamp reading, "Received August 25, 1949 E. F. Grandy, Inc." The letter commences by saying:

> "We are enclosing a copy of our revised quotation on equipment for the above mentioned laboratory."

There is no evidence that a copy of such revised quotation was included with the copy of American Seating Company's August 23, 1949, letter. The revised quotation referred to is probably Exhibit 5 [R. 156].

The evidence indicates that Exhibit 5 was received by Grandy, Inc., on September 24, 1949, and notwithstanding the fact that it was addressed "To all contractors" and dated August 22, 1949, there is no evidence that it was transmitted to Grandy, Inc., before September 24, 1949.

On this same date, September 24, 1949, Grandy, Inc., received a copy of a purchase order, Exhibit 7 [R. 161]. The original of this order was sent to the addressee thereof, American Seating Company, by V. L. Murphy, the subcontractor [R. 81]. Only a copy was sent to Grandy, Inc. [R. 82]. It may be significant to note that the copy of the revised quotation, Exhibit 5, and the copy of the purchase order, Exhibit 7, were received by Grandy, Inc., on the same day. There is no evidence of a transmittal letter accompanying either of these exhibits, nor is there any evidence which specifies the reason for sending these copies to Grandy, Inc.

By letter dated September 26, 1949 [Ex. 8, R. 163], Grandy, Inc., forwarded to the Officer-in-Charge of Construction, U. S. Naval Base, Los Angeles, at Long Beach, California, four copies of the purchase order issued by V. L. Murphy to American Seating Company. The full text of the lettter is as follows:

> "1. Enclosed herewith four (4) copies Purchase Order from V. L. Murphy, plumbing sub-contractor, to American Seating Company, agents for Kewaunee Manufacturing Company for chemical laboratory equipment presently being manufactured at Adrian, Michigan.
>
> "2. It is requested that the Officer-in-Charge of Construction do everything possible to expedite factory inspection in order that, immediately upon completion, this equipment may be forwarded for installation."

On December 20, 1949, American Seating Company wrote to Mr. E. F. Grandy, president of Grandy, Inc., advising that three items of the equipment being furnished

by American Seating Company were being corrected [Ex. 9, R. 164]. On December 22, 1949, Grandy, Inc., wrote to Officer-in-Charge of Construction, Attention: Contract Superintendent, enclosing three copies of certain correspondence received from American Seating Company [Ex. 10, R. 165], but the enclosures are not identified or attached to the exhibit and there is no evidence as to what may have been enclosed. The purpose for which this document, and apparently others, was introduced appears in the record at page 126. Counsel for appellee stated:

> "The purpose of these documents is to show the notice that E. F. Grandy had of the fact that American Seating Company was the supplier of material to its subcontractor in connection with this work, something counsel has attempted to deny and admit in various forms."

On January 6, 1950, Grandy, Inc., wrote to American Seating Company enclosing a copy of a letter received by Grandy, Inc., from the Officer-in-Charge of Construction relative to non-compliance with specific requirements (which enclosure does not appear in the record) saying [Ex. 11, R. 165-170]:

> "You are, no doubt, aware that the above mentioned noncompliance constitutes a very effective block to receipt of funds for work already performed in the contract at Seal Beach.
>
> "In view of this condition, it is requested that your firm make all possible effort to comply with the required work outlined in the enclosed letter."

American Seating Company invoiced V. L. Murphy for $6,124.37, including 3% State Sales Tax, by invoice dated March 15, 1950. The invoice appears in the record as an

enclosure to Exhibit 12 at page 168 and reads in part as follows:

> "No. 58706 OR/CO Date: 3-15-50
>
> Sold to: V. L. Murphy, Plumbing & Heating, Mr. V. L. Murphy, Box 214A, Route 1, Anaheim, California.
>
> Ship to: Quality Control Surveillance Laboratory, U. S. Naval Ammunition and Net Depot, Seal Beach, California
>
> Date Entered: 6-27-49; Ship when: S.A.P.; Routing: Best way ppd; F.O.B.: Dest set up (not connected); Salesman: Mullen; Cust. No. 179. Terms: Net 30 days from date of invoice."

There are no other exhibits which are dated prior to completion of the contract.

Performance under the prime and subcontracts was completed and accepted by the United States in June of 1950 [R. 19, 31, 84, 102, 173]. Grandy, Inc., was paid in full [R. 76, 84]. Grandy, Inc., in turn paid V. L. Murphy in full by honoring the assignment to The Farmers and Merchants Bank of Long Beach [R. 31, 89] and the said bank credited the amount received on the indebtedness due it from V. L. Murphy [R. 29]. The final payment was made by Grandy, Inc., on July 17, 1950 [R. 89]. But V. L. Murphy did not pay American Seating Company.

The next action disclosed by the record is a letter addressed to Glens Falls by American Seating Company demanding payment under the payment bond. This letter is dated December 1, 1950, and is Exhibit 12 [R. 166]. At the pre-trial hearing counsel for American Seating

Company stated that a copy of this letter was also sent to Grandy, Inc. [R. 85]. There is nothing in the record other than the aforementioned statement of counsel to show that American Seating Company ever notified Grandy, Inc., that American Seating Company had not been paid and there is no evidence that American Seating Company ever made a demand upon Grandy, Inc., for payment.

On December 22, 1950, American Seating Company wrote another letter to Glens Falls requesting a written reply to the December 1, 1950, letter. This is in the record as Exhibit A [R. 174]. On January 3, 1951, Glens Falls replied to American Seating Company's demand against Glens Falls dated December 1, 1950 [Ex. 12, R. 166] and denied liability [Ex. 13, R. 169]. The only other exhibits which were introduced were Exhibit 17 [R. 172] and Exhibit C [R. 176]. These exhibits relate to the interrogatories and will be mentioned later.

On or about February 9, 1951, American Seating Company filed suit against V. L. Murphy in the Superior Court of Los Angeles County, case No. 582,886, and was awarded judgment on the 6th day of March, 1952, in the sum of $6,681.78 for the same materials which are the subject matter of this action [R. 31, 86]. According to the statement of counsel for American Seating Company, this judgment has never been collected and it is uncollectible because V. L. Murphy is insolvent [R. 86]. On July 2, 1952, American Seating Company instituted the instant action.

All of the allegations of the complaint [R. 3-9] and the invoice of American Seating Company [R. 168] show that the demand of American Seating Company is the

sum of $6,124.37. Both counsel understood and agreed that this was the amount in controversy [R. 76, 96]. However, in the answer of Grandy, Inc., to interrogatory No. 4 propounded by American Seating Company, there was an obvious typographical error [R. 18]. Instead of the figure $6,124.37, the answer contained the figure $61.37. It is apparent to anyone that two digits had been omitted, to wit, the third and fourth digits, the 2 and the 4.

Mr. Green, counsel for American Seating Company, recognized this fact and wrote to Mr. McCall requesting correction [Ex. C, R. 176]. Mr. McCall replied by letter acknowledging the error [R. 172]. In this letter a further obvious typographical error appears and the sum is given at $6,356.00 for no apparent reason. In presenting the matter of this correction to the court at the trial, Mr. Green commenced to read the corrections into the record and correctly states [R. 115]:

> "Where it shows $61.37 at line 12, it should be $6,124.37."

There being no objection to this, the clerk apparently interlineated the correction [R. 18].

Mr. Green then commenced to state his own conclusions as to the further content of Mr. McCall's letter to which Mr. McCall objected. Mr. McCall then suggested that both letters be introduced as evidence and this procedure was agreed upon. Whereupon Mr. Green perceived that Mr. McCall's typographical error might be considered to be an admission, and thereupon, with leave of court granted, amended the prayer to his complaint by interlineation to state the erroneous figure which appeared in Mr. McCall's letter [R. 118]. Neither Mr. McCall nor Mr. Sturr recognized the significance of Mr. Green's

action [R. 118], There is no support for this figure in the body of the complaint [R. 3-9], in the invoice of American Seating Company [R. 168] or elsewhere in the evidence or agreed statement of facts. Counsel for American Seating Company has incorporated this error into the judgment for an advantage of $231.63.

There are no further facts which appear in the record, but it has been argued as a matter of fact and alleged in the complaint that Grandy, Inc., and Glens Falls knew or should have known that the items supplied by plaintiff's would have to be bought by plaintiff. There was no evidence introduced specifically upon this point. It appears that counsel relies upon the exhibits, all of which have heretofore been mentioned, to establish these contentions [R. 76].

IV.

Questions Involved and the Manner in Which They Are Raised.

All of the questions involved were raised in Points on Which Appellants Intend to Rely on Appeal [R. 178-187]. These Points on Which Appellants Intend to Rely on Appeal are repeated in this brief at Point V under the heading Specification of Error Relied Upon and they are numbered in the same way they are numbered in Points on Which Appellants Intend to Rely on Appeal so that the court in turning to these points as referenced in the following questions may turn to the equivalent numbers under Point V which follows in this listing of questions in this brief.

The Points on Which Appellants Intend to Rely are drawn for the purpose of specifying the error relied upon

and relate separately to the performance bond, to the payment bond and also separately to each appellant. The questions involved are common to a number of the individual points of error. Reference will therefore be made to a number of Points on Which Appellants Intend to Rely under each question involved which in turn contain reference to the Findings and Conclusions.

1. **Was There Either an Express or an Implied Contract Between American Seating Company and Appellants, or Either of Them?**

The contention of appellee that an express or implied contract existed between American Seating Company and appellants, and each of them, does not appear in the complaint, but appears for the first time in argument of counsel for appellee at the trial [R. 129, 141, 142] and it appears in the Findings of Fact, paragraph 6 [R. 39] in vague and uncertain language, to wit:

> "and that there existed a contractual relationship relating to said performance bond and payment bond between plaintiff and defendants E. F. Grandy, Inc. and Glens Falls Indemnity Company, and each of them."

This Finding was objected to and its erroneous nature was one of the grounds alleged in Motion for New Trial [R. 43-55] at Point 1(c) [R. 45-46] and it was raised in Points on Which Appellants Intend to Rely on Appeal as Point 3 [R. 184], 4 [R. 184], 5 [R. 185], 6 [R. 185], 8(A) [R. 186] and 8(B) [R. 187].

For argument concerning this question, see this brief, heading VII-1.

2. **Has the Contractor Obligated Itself to Perform the Contract Obligations of Its Subcontractor by Accepting a Surety Bond as Obligee Thereunder?**

This question is raised by Finding of Fact 6 [R. 39] to the effect that there existed a contractual relationship between appellee and appellants relating to the surety bonds, and by Conclusion of Law I [R. 41]. Appellants argued the point upon Motion for New Trial and it was raised in Points on Which Appellants Intend to Rely on Appeal at Point 1(B) [R. 179], 1(E) [R. 181], 2(A) [R. 181], 2(D) [R. 183] and 6 [R. 185].

For argument concerning this question see this brief, heading VII-2.

3. **Where There Is a Performance Bond and a Separate Payment Bond, Is the Obligation of the Surety on the Performance Bond Void Upon the Performance of the Contract, Even Though the Materialmen Have Not Been Paid?**

This question is raised by the complaint and the respective anwers in every respect wherein appellee relies upon the performance bond for recovery, the Findings of Fact, particularly Finding of Fact 6 [R. 39] and by Points on Which Appellants Intend to Rely on Appeal 1(A) [R. 178], 1(C) [R. 180] and 1(D) [R. 180].

For argument on this question, see this brief, heading VII-3.

4. **If the Parties to a Common Law Payment Bond Intended It Solely as a Protection Against Loss or Damage to the Obligee, Is a Stranger to the Bond Entitled to Recover Against the Surety?**

This question was raised by the complaint and the respective answers, by appellee's interrogatory No. 27 to Grandy, Inc. [R. 22] and by appellee's request for admissions No. 4 [R. 27]; it was an issue at the trial, and is again posed in the Findings of Fact and Conclusions of Law as indicated in Points on Which Appellants Intend to Rely on Appeal 1(E) [R. 181], 2(C) [R. 183], 2(D) [R. 183].

For argument on this question, see this brief, heading VII-4.

5. **On a Bond Conditioned Against Loss or Damage to the Obligee, as Distinguished From a Bond Conditioned Against Liability, Does the Surety Incur Liability Before the Obligee Has Actually Suffered Such Loss or Damage?**

This question is first raised by the complaint and the answers of appellants, was raised at the trial, was set forth in Motion for New Trial [R. 43], and is the subject matter of Points on Which Appellants Intend to Rely on Appeal, Point 2(B) [R. 182].

For argument on this point, see this brief, heading VII-5.

6. **Has the Trial Court Erred in Granting Judgment for Interest From June 1, 1949, to Date of Judgment.**

This question first arose as a result of Finding of Fact 7 [R. 39] and is raised by appellants by Points on Which Appellants Intend to Rely on Appeal, Point 7 [R. 186].

For argument on this point, see this brief, heading VII-6.

V.

Specification of Error Relied Upon.

(This is a duplication of Points on Which Appellants Intend to Rely, appearing in the record at pages 178 to 188, inclusive.)

1. Judgment Against Appellant Glens Falls Indemnity Company and E. F. Grandy, Inc., or Either of Them, Cannot Be Predicated Upon the Common Law Performance Bond.

A. The performance bond here involved is a common law indemnity bond as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned upon the performance of the subcontract by V. L. Murphy. There is no allegation in the complaint, no evidence was introduced and no Finding of Fact was made to the effect that the obligation of said bond was in full force and virtue at the time of the institution of this action. Therefore, Conclusion of Law I, concluding that appellee is entitled to recover against appellants, is reversible error because said Conclusion and the Judgment are not supported by the pleadings, the evidence or the Findings insofar as said Conclusion and Judgment may be based upon the performance bond.

B. The performance bond cannot be the basis for Judgment against appellant E. F. Grandy, Inc., for the further reason that said E. F. Grandy, Inc., was the obligee thereunder and as such is the person for whose benefit and protection the bond was written and pursuant to which no liability whatsoever was created against or as-

sumed by the obligee, E. F. Grandy, Inc. Conclusion of Law I and the Judgment against appellant E. F. Grandy, Inc., are erroneous because they are against the law insofar as they may be predicated upon the said bond. There is no evidence and no Finding of Fact and no Conclusion of Law to the effect that said bond conferred, created or gave rise to any liability, claim or cause of action or right of any kind against appellant E. F. Grandy, Inc., the obligee, and the Judgment is therefore unsupported by the evidence, the Findings of Fact and the Conclusions of Law and the Court erred in granting the same insofar as it may be predicated on said bond.

C. The performance bond is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them for the sole purpose of, and restricted by its terms, to indemnifying the contractor, appellant E. F. Grandy, Inc., against the failure of the subcontractor to fully perform the subcontract. To predicate judgment upon the performance bond against the surety, appellant Glens Falls Indemnity Company, the trial court must affirmatively find that the subcontractor failed to perform the subcontract and that appellant E. F. Grandy, Inc., has been damaged thereby. It was reversible error for the trial court to grant judgment against appellant Glens Falls Indemnity Company because there is no evidence to support a finding that appellant E. F. Grandy, Inc., was

damaged by failure of the subcontractor to perform the subcontract and none was made and Conclusion of Law I is therefore unsupported by the Findings of Fact insofar as said Conclusion of Law is based upon the performance bond.

D. As a matter of law, a common law indemnity bond such as the performance bond here involved does not confer, create or give rise to any liability, claim or cause of action or right of any kind in favor of third parties and therefore, insofar as Conclusion of Law I and the Judgment for appellee against appellant, or either of them, as surety and obligee, respectively, are based upon any rights supposedly created by the terms and provisions of this bond, the said Conclusion of Law and the Judgment are erroneous because they are against the law.

E. Finding of Facts 6 that the performance bond was written "in part for the protection of plaintiff to the extent of plaintiff's claim" and "that there existed a contractual relationship relating to said Performance Bond . . . between plaintiff and the defendants . . . and each of them" is wholly unsupported by the evidence and therefore erroneous. The trial court committed reversible error insofar as said Finding may be a Conclusion of Law, because it is unsupported by the Findings of Fact and the evidence and therefore does not support Conclusion of Law I or the Judgment against appellants, or either of them.

2. **Judgment Against Appellants Glens Falls Indemnity Company and E. F. Grandy, Inc., or Either of Them, Cannot Be Predicated Upon the Common Law Payment Bond.**

A. The payment bond here involved is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor by V. L. Murphy, an independent subcontractor, pursuant to the terms of a subcontract between them and was conditioned to indemnify said appellant obligee against loss resulting to said appellant obligee by reason of the relationship of contractor and subcontractor. Appellant E. F. Grandy, Inc., was the person for whose benefit and protection the bond was written and pursuant to which no liability whatsoever was created against or assumed by the obligee, E. F. Grandy, Inc. Conclusion of Law I and the Judgment against said appellant are erroneous because they are against the law insofar as they may be predicated upon the said bond. There is no evidence and no Finding of Fact and no Conclusion of Law to the effect that said bond conferred, created or gave rise to any liability, claim or cause of action or right of any kind against Appellant E. F. Grandy, Inc., the obligee, and the Judgment is therefore unsupported by the evidence, the Findings of Fact and the Conclusions of Law and the Court erred in granting the same insofar as it may be predicated on said bond.

B. The payment bond here involved is a common law indemnity bond, as distinguished from a bond required by statute, and it was furnished to the obligee, appellant E. F. Grandy, Inc., contractor, by V. L. Murphy, an independent subcontractor, pursuant to the terms of a sub-

contract between them and was conditioned to indemnify said appellant obligee against loss resulting to said appellant obligee by reason of the relationship of contractor and subcontractor. To predicate Judgment upon this payment bond against the surety Glens Falls Indemnity Company, the trial court must affirmatively find that appellant E. F. Grandy, Inc. has suffered such loss. There is no evidence in the record and no Finding of Fact or Conclusion of Law to the effect that the claim of appellee against appellant E. F. Grandy, Inc., arose by reason of the relationship of contractor-subcontractor existing between appellants and resulted in a loss to appellant E. F. Grandy, Inc., and Conclusion of Law I is therefore unsupported by the evidence and the Findings of Fact; and the court committed reversible error in granting Judgment against appellant Glens Falls Indemnity Company.

C. As a matter of law, a common law indemnity bond such as the payment bond here involved does not confer, create or give rise to any liability, claim or cause of action or right of any kind in favor of third parties and therefore insofar as Conclusion of Law I and the Judgment for Appellee against appellants, or either of them, as surety and obligee, respectively, are based upon any rights supposedly created by the terms and provisions of this payment bond, the said Conclusion of Law and Judgment are erroneous because they are against the law.

D. Finding of Fact 6 that the performance bond was written "in part for the protection of plaintiff to the extent of plaintiff's claim" and "that there existed a contractual relationship relating to said . . . Payment Bond between plaintiff and the defendants . . . and each of them" is wholly unsupported by the evidence and

therefore erroneous. The trial court committed reversible error insofar as said Finding may be a Conclusion of Law because it is unsupported by the Findings of Fact and the evidence and therefore does not support Conclusion of Law I or the Judgment against appellant, or either of them.

3. **Judgment Against Appellant Glens Falls Indemnity Company Cannot Be Predicated Upon a Contractual Relationship Between Appellee American Seating Company and Appellant Glens Falls Indemnity Company.**

There is no allegation in the complaint of either an express or implied contract between appellee and appellant Glens Falls Indemnity Company, no evidence thereof was introduced, and Finding of Fact 6 is inadequate in this respect. Conclusion of Law I and the Judgment are therefore unsupported by the evidence and the Findings, and the trial court erred insofar as the Conclusions of Law and the Judgment may be based upon an express or implied contract between said parties.

4. **Judgment Against Appellant Glens Falls Indemnity Company Cannot Be Predicated Upon a Contractual Relationship Between Appellee American Seating Company and Appellant E. F. Grandy, Inc.**

The performance bond and the payment bond of appellant Glens Falls Indemnity Company related exclusively to the subcontract between V. L. Murphy, the subcontractor, and E. F. Grandy, Inc., the contractor. Any direct contractual relationship whether arising by express agreement or by implication of law between appellee and E. F.

Grandy, Inc., would be outside the scope of either of said bonds. The trial court erred in granting Judgment against appellant Glens Falls Indemnity Company insofar as such Judgment may be based upon a contract between appellee and appellant E. F. Grandy, Inc., because such a contract is outside the scope of the said bonds since it is not the contract with respect to which the contract of indemnity was furnished and Conclusion of Law I and the Judgment are unsupported by the Findings of Fact in this respect.

5. Judgment Against Appellant E. F. Grandy, Inc., Cannot Be Predicated Upon a Contractual Relationship Between Appellee and Appellant E. F. Grandy, Inc.

There is no allegation in the complaint of either an express or implied contract between appellee and appellant E. F. Grandy, Inc., and no evidence thereof was introduced and Finding of Fact 6 is inadequate in this respect, and Finding of Fact 7 reciting that appellant E. F. Grandy, Inc., approved the contract between appellee and V. L. Murphy is unsupported by the evidence. Conclusion of Law I and the Judgment are therefore unsupported by the evidence and the Findings and the trial court erred insofar as the Conclusions of Law and the Judgment may be based upon an express or implied contract between said parties.

6. **The Findings of Fact and Conclusions of Law Are Vague and Indefinite and Inadequate to Disclose the Factual or Legal Basis for the Judgment and Are Inherently Inconsistent Because They Cannot Be Interpreted in Any Manner Which Would Result in Joint Legal Liability of Appellants.**

Liability must be predicated upon the bonds or either of them or upon the existence of an express or implied contract between appellee and appellants or either of them. Under the first alternative appellant E. F. Grandy, Inc., could not be liable because as already noted in points IB and 2A said appellant was the obligee and as such the party to be protected. The bonds created no right in favor of any party against said obligee. Under the second alternative, each party would be liable for his own contract with appellee and such a contract was not the subject matter of either bond and outside of the scope thereof and therefore not affected by the provisions of either of said bonds in any manner. As above pointed out, neither party was obligated to appellee by direct contract either express or implied, but any such contract could affect the contracting party only.

7. **The Trial Court Erred in Granting Judgment for Interest From June 1, 1949, to Date of Judgment.**

Finding of Fact 7 to the effect that on the 1st day of June, 1949, appellee furnished the goods referred to in the complaint and Finding of Fact 9 that the sum mentioned therein was due and owing to appellee from appellants from and after the 1st day of June, 1949, are both entirely

unsupported by the evidence. It was error for the court to so find and to adopt Conclusion of Law I and grant Judgment, both based upon said Findings.

8. The Findings Are Unsupported by the Evidence in the Following Additional Material Respects:

A. Finding of Fact 6 is unsupported by the evidence to the extent that it is therein found that appellants, or either of them, knew that in order for the subcontractor "V. L. Murphy to carry out this contract, it would be necessary for him to purchase and obtain supplies from plaintiff."

B. Finding of Fact 8 is unsupported by the evidence.

C. Finding of Fact 10 is in error in the following material respects: In every respect wherein it is hereinabove alleged that the Findings are not supported by the evidence the court further erred by not affirmatively finding that the contrary is true since in each instance the correlative allegation of the complaint was denied in the respective answers and appellee had the burden of proof.

VI.

Introduction to Argument.

The two bonds which are involved in this action are common law bonds, both of which were furnished to comply with the terms of the subcontract between Grandy, Inc., and V. L. Murphy. They are not required by statute, and the terms thereof are not governed by statute. They are private contracts. This is fully understood and conceded by appellee [R. 135, 143].

The fact that Grandy, Inc., as prime contractor with the Government, posted a Miller Act bond in reliance upon which appellee might have successfully prosecuted an action for payment is mentioned because if an action under the Miller Act had been successfully prosecuted by American Seating Company, Grandy, Inc., would have suffered loss and damage as a principal upon such Miller Act bond. If Grandy, Inc.'s liability had been the result of V. L. Murphy's default, Glens Falls would in turn have been liable on its payment bond to Grandy, Inc. Loss or damage resulting to Grandy, Inc., from default by V. L. Murphy was the hazard against which Grandy, Inc., sought to protect itself by requiring V. L. Murphy to supply the Glens Falls bonds and the only circumstance which could impose liability upon Glens Falls.

Aside from the documents themselves, the only evidence of intention of the parties is (1) the answer of Grandy, Inc., to appellee's interrogatory No. 27 [R. 22], and to the same effect (2) the answer of Grandy, Inc., to request for admissions No. 4 which we quote in full [R. 27]:

> "Answer: Affiant's purpose in securing the payment bond was to protect E. F. Grandy, Inc., and no one else, against loss."

While the action is based solely upon contract, counsel for American Seating Company makes an unusual argument which appellants conceive to be entirely outside the scope of the issues, but the trial court did not write a decision and the Findings of Fact and Conclusions of

Law are too vague and indefinite to point to the theory upon which the court found liability. The argument is that Grandy, Inc., prevented V. L. Murphy from paying American Seating Company.

This contention apparently rests entirely upon the fact that in Exhibit 1 [R. 146] Grandy, Inc., suggested a method of financing to V. L. Murphy and that V. L. Murphy availed himself of this suggestion by making an assignment of his subcontract to the Farmers and Merchants Bank of Long Beach, which assignment was recognized by Grandy, Inc., and payments on the contract obligations were made in compliance with this assignment. The fact that the bank subsequently loaned $46,000.00 to V. L. Murphy which sum was ample to pay many times over the total amount owing to appellee, is completely ignored by appellee but adequately disposes of the argument.

The Motion for New Trial [R. 43-55] sets forth in detail the manner in which the Findings are not supported by the evidence and the Conclusions are not supported by the Findings. The Specifications of Error Relied Upon, heading V of this brief, specifically point to the errors of the trial court. One of the errors claimed is that the Findings are too vague and indefinite to disclose the legal foundation for the judgment. The argument following is designed to show that the various theories suggested by the Findings and Conclusions and at the trial are all unsound.

VII.

ARGUMENT.

1. There Was Neither an Express nor an Implied Contract Between American Seating Company and Appellants, or Either of Them.

A. There Was No Privity of Contract Between American Seating Company and Grandy, Inc., and There Was Nothing From Which a Contract Could Be Implied.

(a) There Is No Evidence of an Oral or Written Contract.

There is no allegation in the complaint of either an express or implied contract between American Seating Company and Grandy, Inc., but in Finding of Fact 6 [R. 39], which is a Finding respecting paragraph VI of the complaint, a statement was added "that there existed a contractual relationship relating to" the respective bonds between American Seating Company and both appellants, and each of them. The nature of such a contractual relationship is purely a matter of speculation.

The Finding referred to does not support a concept of an express or implied contract directly between the parties named. Appellants assert that there is no Finding which could support a Judgment based upon a direct contract. However, counsel for appellee argued at the trial that such a contract was established by the evidence and argued the same point at the hearing on Motion for New Trial, even after the Findings were made and entered. As an abundance of caution, we address ourselves to this issue, both from the standpoint that there is no Finding to support the Judgment if based upon such a concept and from the standpoint that the evidence does not establish the fact.

There has been no indication that appellee contends that there was any oral contract between American Seating Company and Grandy, Inc. On the contrary, appellee apparently relies upon the exhibits to prove that there was a contract between Grandy, Inc., and American Seating Company [R. 129]. At the trial [R. 141] counsel for appellee contended that the purchase orders from V. L. Murphy to American Seating Company passed through the hands of Grandy, Inc. As has already been noted in the Statement of Facts, Grandy, Inc., received *copies* only of Exhibits 5, Exhibit 6 and Exhibit 7.

Exhibit 5 was the revised quotation which reached Grandy, Inc., on the same day that Grandy, Inc., received a copy of the purchase order from V. L. Murphy to American Seating Company. Note that the *original* of this purchase order went directly from V. L. Murphy to American Seating Company [R. 81]. Exhibit 6, which is a copy of a letter addressed to V. L. Murphy by American Seating Company, was sent to Mr. Grandy, who was President of Grandy, Inc., in order to keep him advised. No argument need be addressed to the fact that every prime contractor must of necessity keep himself fully advised as to the progress of the work of his subcontractors and that constant attention to the progress of his subcontractors is not only customary, but a vital necessity and an exercise of only reasonable prudence in the contracting business.

Appellants submit that transmittal of a copy of Exhibit 6, a letter explaining the current status of negotiations between the subcontractor, V. L. Murphy, and American Seating Company and the transmittal of Exhibit 5, which is a copy of the revised quotation of American Seating Company, and Exhibit 7, which is a copy

of the purchase order, was in the normal course of business. Transmittal and receipt of these documents in no way indicates contractual liability or intent between Grandy, Inc., and American Seating Company.

Also, in the ordinary and usual course of business, Grandy, Inc., forwarded four *copies* of the purchase order to the Officer-in-Charge of Construction, United States Naval Base, "to expedite factory inspection in order that, immediately upon completion, this equipment may be forwarded for installation." [R. 163.] The Officer-in-Charge was not requested to transmit any of these copies to American Seating Company and there is no evidence whatsoever that he did so.

Knowledge on the part of Grandy, Inc., that American Seating Company was furnishing the material has no significance. Subsequent correspondence, such as American Seating Company's letter to Mr. Grandy [Ex. 9, R. 164], advising that certain items of equipment being furnished by American Seating Company were being corrected, and the January 6, 1950, letter [Ex. 11, R. 165-170] are both matters which again indicate vigilance on the part of the prime contractor to perform its duty to see to it that the work was promptly completed. The December 22, 1949, letter [Ex. 10, R. 165] from Grandy, Inc., to the Officer-in-Charge of Construction has no significance because it is not accompanied by identification of the enclosures and is simply a letter of transmittal.

The foregoing documents do not indicate an express contract in writing. There is no indication of an offer and acceptance or a manifestation of mutual assent. The essential ingredients of a contractual relationship are wanting. (See *Restatement, Contracts,* Secs. 19 and 20.) This

is an application of the most general contract principles with no refinement and consequently further citation of authority is unnecessary.

(b) No Contract May Be Implied From the Conduct of the Parties; and Grandy, Inc., Has Paid the Full Subcontract Price and Therefore Has Not Been Unjustly Enriched.

There remains the question of whether or not the contract may be implied in law or in fact. American Seating Company never looked to Grandy, Inc., for payment prior to filing the instant action. The invoice of American Seating Company, copy of which is attached to Exhibit 12 [R. 168] shows, "Sold to: V. L. Murphy, Plumbing and Heating." This was dated March 15, 1950. There is no indication that a copy of this invoice ever went to Grandy, Inc., or to Mr. Grandy, its President. American Seating Company next made demand upon Glens Falls, not upon Grandy, Inc., by letter dated December 1, 1950, which is Exhibit 12 [R. 166] and subsequently brought suit against V. L. Murphy in the Superior Court of Los Angeles County and prosecuted the case to judgment. Grandy, Inc., could have been joined in this action, but was not. The conduct of American Seating Company is such as to indicate that it did not expect payment from Grandy, Inc.

Counsel for appeellee argues that Grandy, Inc., knew that American Seating Company furnished the supplies which are the subject of the suit and neither paid appellee nor took any steps to be sure that V. L. Murphy would pay for the materials [R. 141]. Counsel for appellee says an implied contract is shown by the exhibits [R. 142]. He does not properly quote the evidence in that he states that the evidence is that the purchase order

went from V. L. Murphy through the office of Grandy, Inc., to the Navy and back to American Seating Company, which, as we have seen, is not the case. He also states without support in the evidence that Grandy, Inc., set up the specifications. The record shows that the specifications were supplied by the Government in the prime contract, Exhibit B. See also Exhibt 6 [R. 158] wherein American Seating Company reports that it had prepared drawings and negotiated for approval by the Department of Public Works at the Naval Base before sending copies thereof through channels.

As another element, appellee contends, and the court found, that Grandy, Inc., knew that in order for V. L. Murphy to carry out his contract, it was necessary for him to purchase and obtain supplies and materials from plaintiff [Finding 6, R. 39]. This Finding is entirely unsupported by the evidence. The evidence indicates that Grandy, Inc., knew that V. L. Murphy was purchasing these materials from appellee, but goes no further. For all that appears in the evidence, these supplies could be purchased from any vendor of equipment which would meet the specifications of the Government.

It is also contended that the goods in question were delivered to Grandy, Inc., and received by Grandy, Inc. The materials in question were delivered by American Seating Company to Quality Control Surveillance Laboratory, United States Naval Ammunition and Net Depot [Purchase order of March 15, 1950, R. 168]. At no time did any title or possession or control pass to Grandy, Inc. After delivery of the goods, they were under the custody and control of V. L. Murphy, the subcontractor, and after installation they became a part of the work which was owned by the Government.

To support the implied contract theory appellee points to Finding of Fact 8 [R. 40] that Grandy, Inc., received payment from the United States Government for the materials furnished by the plaintiff. Grandy, Inc., received payment for performance of his prime contract with the Government, which, of course, incidentally and necessarily included all of the labor and materials which went into the contract. Appellant Grandy, Inc., was not unjustly enriched. The full amount of its obligation under the subcontract was paid [R. 31].

B. There Was No Privity of Contract Between American Seating Company and Glens Falls and There Was Nothing From Which a Contract Could Be Implied.

As in the case of Grandy, Inc., there is no fact and no Finding of Fact or Conclusion of Law to support the Judgment if it is based upon the argument of appellee that a direct contract of any kind existed between Glens Falls and American Seating Company whereby Glens Falls promised to pay American Seating Company for the materials furnished to V. L. Murphy.

C. Glens Falls Is Not Surety to Protect Grandy, Inc., From Loss or Damage Resulting From Failure of Grandy, Inc., to Perform Its Own Contract.

The undeniable and persistent error of the Judgment and Conclusion of Law I is that appellants have been found liable to appellee jointly. This is to say that both appellants are liable to the same extent on the same obligation. It seems quite apparent to appellants that joint liability cannot be found because of an express or implied contract between American Seating Company and Grandy, Inc., unless Glens Falls was also a party to the

express contract or the implied obligation. No more can be said but that there is no evidence of any joint contract.

Glens Falls is in no way associated with Grandy, Inc., except as surety on the bonds in question. These bonds related to the subcontract only and not to any direct contract between Grandy, Inc., and American Seating Company. They were furnished to protect Grandy, Inc., against loss or damage which might fall upon Grandy, Inc., because of some act or omission of V. L. Murphy, the subcontractor.

Under these circumstances, there are three possible alternative methods of liability of either Glens Falls or Grandy, Inc., but not of both, as follows:

(1) Liability of Grandy, Inc., by virtue of an express or implied promise to pay American Seating Company.

(2) Liability of Glens Falls by virtue of an express or implied promise to pay American Seating Company.

(3) Liability of Glens Falls on its surety bond.

Each of these possible methods of liability is mutually exclusive of the other. The only basis advanced to impose liability on Grandy, Inc., is that it promised American Seating Company to pay for the equipment in question. Under such circumstances, a joint judgment against both appellants is manifest error.

2. **By Accepting a Common Law Surety Bond as Obligee Thereunder, the Prime Contractor, Grandy, Inc., Has Not Obligated Itself to Perform the Contract Obligations of Its Subcontractor.**

It is an elementary principle of the law of suretyship that the obligee of a common law surety bond, including a payment bond, is not liable thereon to a stranger to the bond for the reason that the obligation of the bond runs to and in favor of and for the benefit and protection of, and not against, the obligee of the bond, irrespective of the right, if any, of the stranger to recover from the principal or surety under the bond.

50 *Am. Jur.,* Suretyship, Secs. 2 and 3, pp. 903-905;

Restatement, Security, Sec. 82, p. 228.

Finding of Fact 6 [R. 39] to the effect that there existed a contractual relationship relating to the bonds between appellee and Grandy, Inc., is erroneous, both as a matter of fact and as a matter of law. The obligee is the beneficiary and not one who is obligated in the three-cornered relationship of obligor, surety and obligee.

The error of granting a joint judgment is again inescapable. If any of the three parties to the contractual relationship of suretyship is liable to American Seating Company because of that relationship, the obligee is not. Even if the obligee in some other capacity should also be liable to American Seating Company (which appellants assert is not the case), the resulting judgment could not be a joint judgment because the two liabilities do not stem from the same obligation.

3. Where There Is a Performance Bond and a Separate Payment Bond, the Obligation of the Surety on the Performance Bond Is Void Upon the Performance of the Contract, Even Though Materialmen Have Not Been Paid.

In the original subcontract [R. 147] between the subcontractor, V. L. Murphy, and Grandy, Inc., the prime contractor, the only bond required for the protection of Grandy, Inc., was a "performance or completion" bond to be furnished by V. L. Murphy. By subsequent oral agreement, however, it was agreed between said parties that V. L. Murphy would furnish a performance bond and a payment bond [R. 72-73] instead of the "performance or completion" bond referred to in the subcontract.

The condition of the common law performance bond furnished by V. L. Murphy, as principal, to Grandy, Inc., as obligee, was to the effect that if the principal thereunder should "truly perform and fulfill all the undertakings, covenants, terms, conditions, and agreements" of the subcontract between the principal and the obligee, including duly authorized modifications thereof, then said obligation to be void; otherwise, to remain in full force and virtue [Ex. 3, R. 153].

The payment bond furnished by V. L. Murphy, as principal, to Grandy, Inc., as obligee, undertook to hold said obligee

> "free and harmless from and against *all loss and damage* by reason of the failure to promptly pay to all persons supplying labor and materials used in the prosecution of the work provided for in subcontract" [Ex. 4, R. 155]. (Emphasis added.)

Where only one surety bond is supplied with reference to a contract or subcontract which requires furnishing materials or labor, the courts have held that the faithful performance of such a contract contemplates payment for the materials or labor and that the surety has obligated itself therefor.

> *Pacific States Co. v. U. S. Fidelity & G. Co.* (1930), 109 Cal. App. 691, 293 Pac. 812.

As stated in *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387, which cited the *Pacific States* case, the question for the court to decide is: Was the bond a contract expressly made for the benefit of the person seeking to recover under it? The answer to this question depends upon the intent of the parties to the bond. The court quotes with approval the test laid down in other cases cited:

> " 'If it can be fairly said from either the contract or the bond, which are to be construed together, that the parties intended to and did agree to pay such third person, a suit could be brought on such bond by such third person to recover upon the promise so made for his benefit.' "

The court then found that the materialman could not recover upon the bond because it was not intended that the surety should be bound for such payment.

In the *Pacific States* case recovery was allowed. In the *Crane Co.* case recovery was not allowed. The intention of the parties governed in both decisions. Both cases involved but a single bond. The case at bar is to be distinguished from the last two cited cases because the parties have provided two common law bonds, a performance bond and a payment bond. But the question before the court is the same: Was the bond in question

a contract expressly made for the benefit of the person seeking to recover under it?

The parties have provided for the contingency of failure of the subcontractor to pay for the materials. The element of "payment" has been segregated from the "performance" contemplated by the parties under the performance bond and dealt with separately in the payment bond. The performance bond, under such circumstances, is clearly designed to provide the obligee with protection with respect to matters of performance other than the matter of payment for materials. Having varied the requirements of the subcontract by substituting two bonds for one, the parties must have intended this action to have some significance and for each to serve a separate function.

Each must be considered and neither ignored. Both must be deemed to have a purpose. *The intention to supply a payment feature which is implied in a surety bond in instances where there is only one bond is expressly negated when the parties have provided a separate bond for this express purpose.*

Attention is invited to *Lamson Co. Inc. v. Jones* (1933), 134 Cal. App. 89, 24 P. 2d 845. In this case there were two bonds posted: (a) a performance bond and (b) a payment bond. The latter was required by statute. The plaintiff failed to avail himself of the payment bond by allowing the statute of limitations to run against bringing suit on this bond. The plaintiff then sought to recover upon the common law performance bond arguing that performance of the contract contemplated payment for materials used. The court refused recovery, saying at 134 Cal. App. 91:

"Appellant urges that it has a right of action on the faithful performance bond exacted of the contractor under the contract and which was also furnished by respondent. Such bond runs to the city of Glendale only, and there is no provision therein which runs to the benefit of labor or materialmen. It is well settled that where a separate bond has been filed complying with the statute and inuring to the benefit of laborers and materialmen, no recovery can be had by a laborer or materialman upon the faithful performance bond executed in connection with the same contract which does not by its terms inure to his benefit. (*Maryland Casualty Co. v. Shafer,* 57 Cal. App. 580, 208 Pac. 192; *Summerbell v. Weller,* 110 Cal. App. 406, 294 Pac. 414.)"

It is an acknowledged fact that the work of V. L. Murphy under the subcontract was completed and accepted by the Government [R. 31, 96]. At this point the obligation of the performance bond was void according to the condition of the bond. The complaint fails to state a claim upon which a judgment may be based as to the performance bond because it contains no allegation that the said bond was of force and virtue. No evidence, Finding or Conclusion appears in support of a judgment based upon this bond and appellants respectfully submit that this fact indicates that the Judgment is not intended to be based thereon.

Perhaps it would be well to observe that the segregation of the payment feature into a separate payment bond manifests the intention of the parties that the performance bond shall not be a contract for the benefit of appellee to satisfy its claim for payment. We now turn to a consideration of the intention of the parties with respect to the payment bond.

4. **American Seating Company Was a Stranger to the Common Law Payment Bond and Is Therefore Not Entitled to Recover Against the Surety Because at the Time the Bond Was Executed the Parties Thereto Intended It Solely as a Protection Against Loss or Damage to the Obligee, Grandy, Inc.**

As pointed out in the last section of this brief, section 5 under heading VII, the intention of the parties to a surety bond is the determining factor where the court is faced with the problem of determining whether a person who furnished materials to a subcontractor is entitled to sue and recover upon a bond furnished to the prime contractor.

> *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387;
>
> *Lamson Co. Inc. v. Jones* (1933), 134 Cal. App. 89, 24 P. 2d 845.

In giving consideration to the persons who are intended to be benefited by the provisions of a payment bond, care must be taken to distinguish the multitude of cases which involve payment bonds required by statute. The terms and provisions of the bonds required by statute are those required by law regardless of the provisions of the bond or the intention of the parties as expressed in the bond or accompanying instruments, but common law surety bonds are to be construed according to their terms. See *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387, from which we quote:

> " 'It is elementary that: "Sureties are never bound beyond the strict letter of their contract; that they have the right to stand upon the precise terms of their agreement, and that there is no authority for

> extending their liability beyond the stipulation to which they have chosen to bind themselves." Callan v. Empire State Surety Co., 20 Cal. App. 483, 485, 129 P. 978, 981.' W. P. Fuller & Co. v. Alturas School District, 28 Cal. App. 609, 612, 153 P. 743, 745."

The intention of the parties may be ascertained from the record at several places: First in point of time, from the subcontract [R. 147], the principal portion of which concerns the protection of the contractor against various forms of loss or damage. We invite the court's attention to the regular and persistent use of the words, "indemnify and save harmless." Specifically, the contractor has sought to protect himself against liens, stop notices, attachments, garnishments, executions, liability for injury to the public, property damage, injury to workmen, damages resulting from unauthorized use of patents, patent infringement, delay in performance, loss, injury or damages to the building, earthquakes and lack of harmony of employees of subcontractor with employees of contractor [R. 149-151]. It appears from the subcontract that the concern of the contractor is his own protection.

The second element of intention in point of time is the fact that the subcontractor and contractor agreed to provide and accept respectively two bonds, a performance bond and a payment bond, thus intentionally segregating the matter of payment for materials from the elements of performance of the contract. The payment bond having been accepted by the contractor, the terms thereof were obviously satisfactory to him. It might also be pertinent to observe that the custom of segregating the features of performance and payment into two bonds is a well recognized practice authorized by the Miller Act

and a frequent practice in all fields of construction work as the cases in the books indicate. This practice is no doubt attributable to the greater flexibility made possible by segregating these two elements.

The only direct evidence of intention appears in the record in two places: First, in the interrogatories to appellant Grandy, Inc., by appellee wherein appellee asked and appellant Grandy, Inc., answered, at interrogatory No. 27 [R. 22]:

> "27. What was your purpose in requiring V. L. Murphy to furnish you with a bond in the sum of $8,833.58?
>
> Answer: For protection in the event of loss to me."

And again in answer to appellee's request for admissions No. 4, directed to Grandy, Inc., wherein appellant Grandy, Inc., was asked to admit and answer as follows [R. 27]:

> "4. That the purpose of requiring V. L. Murphy to furnish the payment bond referred to in plaintiff's complaint was obtained for the purpose of protecting the defendant, E. F. Grandy, Inc., and any suppliers and material man from any loss due to the failure of V. L. Murphy to pay such material man or suppliers.
>
> Answer: Affiant's purpose in securing the payment bond was to protect E. F. Grandy, Inc., and no one else, against loss."

Grandy, Inc., was interested in protecting itself against the threat of loss as a consequence of the Miller Act. The Miller Act was designed to protect the appellee. Grandy, Inc., had no reason even to be concerned about appellee; and particularly in the light of the protection furnished by the Miller Act, Grandy, Inc., had neither moral nor

legal obligation to seek a bond for the protection of appellee. Should Grandy, Inc., have anticipated that appellee would neglect its rights under the Miller Act? Certainly not! Quite to the contrary, Grandy, Inc., had real reason to expect that as a consequence of the Miller Act, Grandy, Inc., might be compelled to pay a subcontractor's supplier after paying the subcontractor, and Grandy, Inc.'s natural concern would be to protect itself. This explains the character of the bond and the intention of the parties as hereinabove disclosed by the record.

In answer to the test question posed in *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387: "Was the payment bond a contract expressly made for the benefit of appellee?", the record says, no.

Based upon the foregoing discussion in this section and Section 3 preceding it, appellants submit that Finding of Fact 6 [R. 39]:

> "That it is true as alleged in said paragraph that said performance bond and payment bond were written in part for the protection of plaintiff to the extent of plaintiff's claim as made in said Complaint and that there existed a contractual relationship relating to said Performance Bond and Payment Bond between plaintiff and the defendants, E. F. Grandy, Inc., and Glens Falls Indemnity Company, and each of them"

is wholly unsupported by the evidence and, therefore, erroneous, and that as a Conclusion of Law, if the same be so construed, it is likewise erroneous.

5. A Surety Incurs No Liability on a Bond Conditioned Against Loss or Damage to the Obligee, as Distinguished From a Bond Conditioned Against Liability, Until the Obligee Has Actually Suffered Such Loss or Damage.

The distinction between the function of a performance bond and a payment bond when both have been furnished, has already been pointed out. Appellants have also pointed out that the contract has been fully completed within the meaning of the performance bond and that the obligation thereof is therefore void. And in the heading V-4, the point was made that only those who are intended to be benefited by the terms of the bond may sue thereon.

Reflecting the intention of the parties is the manner in which the bond is conditioned. A bond conditioned upon loss or damage to the obligee indicates an intention to restrict its protection to the obligee only. But the manner in which the bond is conditioned has further legal significance. It is well established that suit will not lie against a surety upon such a bond until the loss or damage contemplated has been sustained.

It is unnecessary to consider, in the instant case, whether the procedure of the Federal system will permit cutting across successive steps of the legal process to make the surety on the subcontractor's bond to the prime contractor liable in an action brought by a creditor of the subcontractor who has the unquestioned right to recover against the obligee of such subcontractor's bond as principal under a Miller Act bond. As heretofore pointed out, there is no theory upon which appellee may recover against Grandy, Inc., on a claim arising out of the act or omission of his subcontractor. At least, none has been even suggested.

If suit had been brought under the Miller Act, based upon V. L. Murphy's failure to pay, American Seating Company could have recovered against Grandy, Inc., without question. We conceive that the payment bond was required by Grandy, Inc., in order to provide a solvent indemnitor in such a circumstance. But American Seating Company has not brought such a suit and it is now too late to do so. The result is that Grandy, Inc., has not and will not suffer loss or damage as the result of the failure of its subcontractor to pay American Seating Company. Therefore, appellants contend that appellee did not and cannot state a cause of action against appellants and that there are no facts in the record which will sustain the Judgment and that there is no Finding of Fact which will support Conclusion of Law I and the Judgment.

Section 2778 of Title XII of the California Civil Code provides rules for interpreting an agreement of indemnity and distinguishes between indemnity against liability and indemnity against claims or demands for damages or costs. As to the latter, Section 2778 provides:

> "In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears:
>
> * * * * * * * *
>
> "2. Upon an indemnity against claims, or demands, or damages, or costs, expressly, or in other equivalent terms, the person indemnified *is not entitled to recover without payment thereof;* . . ." (Emphasis added.)

That the law of the State of California is plainly stated in the Civil Code is apparent from the case of *Ramey v.*

Hopkins (1934), 138 Cal. App. 685, 688, 33 P. 2d 433, from which we quote commencing at 138 Cal. App. 688:

> "In 13 California Jurisprudence, page 987, the distinction between a bond against liability and an indemnity contract against loss or damages is clearly enunciated. We quote therefrom: 'The distinction between an undertaking against "liability" and the strict contract of indemnity against "loss" is that between contracting that an event shall not happen, and contracting to indemnify against the consequences of the event if it should happen. A liability is not a damage, according to the signification of that term as employed in contracts of indemnity, and it has been said that courts have no authority to insert the term "liability" in a contract, and then proceed to enforce the contract as they—but not the parties—have made it. A bond indemnifying a person against loss and liability takes effect from its delivery, and its legality is to be determined by reference to the state of things then existing.' And then, on page 991 of the same volume, section 12, the rule is clearly stated that the right of action upon a bond indemnifying against loss or damage accrues only, and at the time when the indemnitee suffers actual loss by being compelled to pay, and the actual payment of damages. The authorities cited in the footnotes so fully support the text which we have quoted that further attempts to distinguish between a bond insuring against liability and one insuring against loss or damages is unnecessary. Nor is it necessary to cite further authorities that before an action can be begun upon a contract of indemnity insuring against loss or damages the damages must have been paid as required by subdivision 2 of section 2778 of the Civil Code." (Emphasis added.)

The *Ramey* case represents the general rule which is recognized and applied in the Federal Courts. (See *United States v. United States Fidelity & Guar. Co.* (C. C. A. 2, 1940), 113 F. 2d 888.)

As already pointed out, the obligee of the payment bond in the case at bar has not suffered loss or damage (payment to appellee being the very loss or damage contemplated); moreover, there is no theory upon which the loss or damage referred to in the bond can legally fall upon him.

6. The Trial Court Erred in Granting Judgment for Interest From June 1, 1949, to Date of Judgment.

Finding of Fact 9 [R. 40] states that the sum awarded in the Judgment has been due and owing from June 1, 1949. Conclusion of Law I states that interest is due from said date and the Judgment so provides.

On June 1, 1949, there was no contract for the purchase of the equipment. American Seating Company's quotation [R. 156], addressed "To All Contractors," was not even dated until August 22, 1949. On August 23, 1949, there was still no firm decision to purchase and install the equipment. The equipment was still on the drawing board. See Exhibit 6 [R. 158]. The purchase order wasn't sent to American Seating Company until at least September 23, 1949, the date it bears [Ex. 8, R. 163].

The date of delivery of the equipment does not appear. As already pointed out, the record discloses no demand made against Grandy, Inc., prior to institution of this action and demand was first made against Glens Falls by letter dated December 1, 1950 [Ex. 12, R. 166]. The invoice to the real purchaser, V. L. Murphy, was dated March 15, 1950.

In short, there is no evidence which will sustain the granting of interest from June 1, 1949, and none which will sustain any award of interest prior to Judgment.

Conclusion.

As in many cases which come before the courts, there is no solution to this case which could be considered a happy ending. American Seating Company is simply asking that its credit loss on a sale to V. L. Murphy, who is insolvent, be passed on to someone else. It is true that American Seating Company is forced to innocently stand a loss, but it is asking the court to make equally innocent parties suffer the loss instead. Appellants respectfully represent that by reason of the errors designated in the Specification of Error Relied Upon and the arguments relating thereto, which hereinabove appear, Judgment should be reversed with instructions to enter Judgment for appellants.

Respectfully submitted,

McCall & McCall and

Albert Lee Stephens, Jr.,

By Albert Lee Stephens, Jr.,

Attorneys for Appellants.

No. 14258.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GLENS FALLS INDEMNITY COMPANY, a New York Corporation, and E. F. GRANDY, INC., a California Corporation,

Appellants,

vs.

AMERICAN SEATING COMPANY, a New Jersey Corporation,

Appellee.

APPELLANTS' REPLY BRIEF.

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Appellee.

APPELLANTS' REPLY BRIEF.

I.

Appellee's Statement of Facts Contains Erroneous Statements Which Are Unsupported by the Record.

The "Concise Statement of Facts" which appears in the brief of Appellee commencing on page 2 contains two statements which heretofore have been made repeatedly in the trial court both of which are erroneous. Appellants made a detailed and accurate statement of facts with numerous references to the record and with adequate quotation of the record to fully disclose the true facts in the hope that Appellee would refrain from repeating these erroneous statements.

The first erroneous statement of fact appears at page 3 of Appellee's brief wherein it is stated that the specifications required V. L. Murphy, the subcontractor, to obtain certain material and equipment from Appellee. The fact is that the specifications do not require the equipment to be purchased from any particular source. So far as the specifications are concerned the equipment could be purchased from any person, firm or corporation manufacturing such material.

The second erroneous statement appears on the same page. Appellee asserts that the prime contractor, Grandy, Inc., forwarded the purchase order of V. L. Murphy to American Seating Company. This statement is likewise completely unsupported in the record. See page 8 of Appellant's Opening Brief for a full statement of facts regarding this matter, but to eliminate further discussion we quote the statement of counsel for Appellee which is binding upon Appellee as a part of the agreed statement of facts made in the trial court [R. 81]:

> "Mr. Green: *Under date of September 23, 1949, a purchase order was sent to American Seating Company by V. L. Murphy. A copy of it was sent to E. F. Grandy and received by them on September 24, 1949,* a photostat of that, with the stamp of the Grandy Company, which has been marked for identification as Plaintiff's Exhibit No. 7." (Italics ours.)

Except as above stated, there is nothing in Appellee's statement of facts which conflicts with the statement by Appellants.

II.

American Seating Was Adequately Protected by Miller Act Bonds. No Intention to Benefit It Appears From a Construction of the Subcontract and the Payment and Performance Bonds.

Passing for a moment Appellee's attempt to avoid the logical force of Appellant's argument by an effort to distinguish the instant case from those cited by Appellant, we first wish to examine the fundamental weakness of Appellee's argument. This is the ostrich-like refusal to recognize that the primary rule of interpretation of contracts is that effect must be given every provision thereof. The rule is the same whether the contract is one instrument or several instruments which must be read or construed together.

Civil Code, Sections 1641, 1642;

Crane Co. v. Borwick Trenching Corporation (1934), 138 Cal. App. 319, 32 P. 2d 387;

Beedy v. San Mateo Hotel Co. (1915), 27 Cal. App. 653, 150 Pac. 810;

Merkeley v. Fisk (1919), 179 Cal. 748, 178 Pac. 945.

12 Cal. Jur. 2d, *Contracts,* Section 123, pp. 333-335.

Thus, in the instant case, Appellee argues that the Performance Bond, the Payment Bond and the Subcontract must be read and construed together. Bearing in mind that when this is so, each must be so construed as to have a place in the entire picture and a meaning, can it be said of the fact that there are two bonds, a Performance Bond and a Payment Bond, instead of a single, all-purpose bond, "This alleged distinction requires no comment?" (Appellee's Br. p. 18.)

Construing all of the instruments together, it bluntly appears that the common-law bonds were required to protect Grandy, Inc. There is no evidence of solicitude for third parties, such as American Seating Company, which is perfectly capable of protecting itself. No duty to protect American Seating Company is imposed by law, except pursuant to the Miller Act (40 U. S. C., Secs. 270a and 270b). Appellee slept on these rights which are ample to protect a vigilant supplier of material and labor. The traditional attitude of contractors in this situation made mechanic's-lien laws and the Miller Act a necessity. If a supplier waives these rights, then he must take his own risks. There is less justice in making the contractor pay twice than there is in letting the supplier suffer his own credit risk. Appellee has neither equity nor sympathy on his side.

If, as Appellee contends, the Performance Bond "includes insurance of payment for labor and material furnished," of what use is the Payment Bond? Such a construction nullifies the value of the Payment Bond. How could the contractor suffer loss or damage from failure of his subcontractor to pay labor or materialmen if he was protected by "an insurance contract" that these would be paid? It is manifest that the argument of Appellee boils down to the idea that the Payment Bond was simply surplusage. We believe that this position is untenable.

The alternative is that the parties intended a division of function between the two bonds. The Performance Bond is silent as to payment. Can it be said that any feature of payment should be implied when there is a separate bond for that purpose? If none can be implied, there is none. Appellee does not contend for more than

an implication which is precluded in this case for the reasons stated.

One more point bears upon the subject of ascertaining the intention of the parties: The prime contract is one of the documents to be considered because it is incorporated by reference into the subcontract [R. 148]. The prime contract contains ample protection for Appellee and all like him because it requires a Miller Act bond. There is no reason to suppose that the contractor or his subcontractor should be further concerned about the welfare and protection of Appellee. But, by the same token, the contractor himself is subject to potential liability, not otherwise existent, by becoming a principal upon the Miller Act bond. His only reasonable concern is for himself, hence the Payment Bond is for his own protection.

III.

The Obligation of a Surety on a Performance Bond Depends Upon the "Intention" of the Parties Thereto as Ascertained From the Facts and Circumstances of Each Case.

The case of *Pacific States Co. v. U. S. Fidelity & G. Co.,* (1930) 109 Cal. App. 691, 293 Pac. 812, is not as broad as Appellee apparently believes. All of the language quoted by Appellee is predicated upon the Court's determination of what the parties *intended* by the contract and the undertaking. Having determined that these instruments clearly implied that it was *intended* that the bond was to assure payment for labor and materials as well as performance of the work, the consequences were clearly ordained.

We cited the later case of *Crane Co. v. Borwick Trenching Corporation* (1934), 138 Cal. App. 319, 32 P. 2d 387,

which adopted the same principle, that is to say, looked to the intention of the contracting parties, and came to a different result. It so happened that the language of the bonds in the respective cases differed and consequently the intention differed as did the result. Each case involved but a single bond. The intention of the parties in the case at bar is as clearly evidenced by the fact that there are two bonds of different functions as by a difference in language. Intention may be expressed in many ways.

Neither the *Pacific States* case nor the *Crane Co.* case, regardless of the language of the respective opinions, cast forever and in every circumstance a single construction upon words of the English language without regard for the surrounding circumstances which clearly indicate contrary intent. Both cases were cited by Appellant to illustrate the fact that intent governs. It is in reality the intent relative to the *surety bond* which must be determined and the other related documents are a part of the surety contract only to the extent that they aid in determining the scope of the surety's obligation.

The Appellee invites the Court's attention to the similarity in the wording of the Performance Bond in the instant case and the single, all-purpose bond in the *Pacific States* case. We respectfully invite the Court's attention to the differences and quote for convenience the provisions of the bond in the *Pacific States* case (109 Cal. App. 693):

> " 'The condition of this obligation is such that if said contract is made, and if the said contractor shall well

> and faithfully keep and perform all of the covenants and agreements of said contract, by them to be kept and performed, *and shall turn over and deliver to said General Contractor, said improvement according to said contract, and shall save and hold harmless the said general contractor from any and all loss or damage arising out of the failure of said contractor to fulfill said contract,* then the above obligation to be void; otherwise to remain in full force and effect.' " (Italics ours.)

This single bond is quite obviously all-purpose, including both performance and payment features, and containing the following further words which are foreign to both the Performance and Payment Bonds in this case:

> "and shall turn over and deliver to said General Contractor, said improvement according to said contract,"

These words, we think, indicate that the intention was to "turn over and deliver" free from liens which would follow a failure to pay for materials and labor since it was a private contract subject to the mechanic's lien laws of the State of California. A realistic appraisal of the language of the *Pacific States* decision must result in the conclusion that the matter of intention of the parties is to be determined by an appraisal of the facts and circumstances of each case and is not a rule of law.

IV.

Cases Cited by Appellants in Their Opening Brief Support the Principle That Intention Governs in the Interpretation of Surety Bonds and the Obligation Thereof and That Such Intention Is to Be Derived From the Facts and Circumstances of Each Case Rather Than by Reference to any Arbitrary Rule or Magic Formula of Words.

In pages 5 through 15 of its brief, Appellee attempts to distinguish cases cited by Appellants in support of the principle that the intention of the parties, as evidenced by the facts and circumstances of each case, governs the interpretation of surety bonds in determining the parties who are to be benefited thereunder.

A brief review of these cases will show that none of them are inconsistent with Appellants' contention.

Crane Co. v. Borwick Trenching Corporation (1934), 138 Cal. App. 319, 32 P. 2d 387, involved a single common-law performance bond. The court looked to the facts and circumstances and found that the parties did not intend to benefit a third party materialman and, therefore, he could not recover from the surety. The court in the *Crane Co.* case distinguished *Pacific States Co. v. United States F. & G.* (1930), 109 Cal. App. 691, 293 Pac. 812, on the ground that the language in the bond there involved was more inclusive than that contained in the bond involved in the other case. Therefore, the *Pacific States* case cannot be regarded as authority for the proposition that use of similar language in one part of a bond always requires the same result, especially where, in addition, there are other differences in language of the respective bonds which must be considered and particularly where there is in addition a payment bond.

In attempting to distinguish *Lamson Co., Inc. v. Jones* (1933), 134 Cal. App. 89, 24 P. 2d 845, Appellee assumes too much (Appellee's Br. 1st par. p. 10).

That case is completely consistent with Appellants' contention here: Where a statutory bond is given for the protection of laborers and materialmen, it is a circumstance to be considered in determining the intention of the parties with respect to a common-law bond, and whether or not they intended its benefits to inure to third parties, not privy thereto. The court in that case decided that where the materialmen and laborers were protected by another bond which happened to be a statutory bond, there was no intention to benefit them by the common-law performance bond and, therefore, they could not maintain suit thereon.

Appellee states (Appellee's Answering Br. p. 8), that the bonds in the instant case meet the test set forth in *Ryan v. Shannahan* (1930), 209 Cal. 98, 104, 285 Pac. 1045, and in the *Pacific States* case. But the *Ryan* case sets forth no particular test other than ascertaining the *intention* of the parties, and the latter case was in later decisions held to turn upon the particular language of the bond under consideration.

Appellee uses several pages to distinguish *Ramey v. Hopkins* (1934), 138 Cal. App. 685, 33 P. 2d 433. (See Appellee's Answering Br. pp. 11-14.) We cited the *Ramey* case to show the distinction, as set forth in Section 2778, California Civil Code, between a bond against liability and an indemnity bond against loss or damage. The question in that case was whether or not the obligee of the indemnity bond against loss or damage might recover from the indemnitor without proving payment of loss or dam-

age, and the court held that it could not. Cases relied on by respondent in the *Ramey* case to support a contrary conclusion dealt with bonds against liability rather than against loss or damage and were distinguished by the court on that basis.

The *Ramey* case and the case of *United States v. United States Fidelity & Guar. Co.* (2 Cir., 1940), 113 F. 2d 888, illustrate why payment bonds, such as are here involved, are furnished. As stated in *United States v. United States Fidelity & Guar. Co., supra,* at page 891:

> "To give the language any meaning it must be construed to refer to such claims as are provable under the Miller Act bond furnished by the obligee. Such was the construction adopted in American Surety Co. v. Wheeling Structural Steel Co., D. C. W. Va., 26 F. Supp. 395, 400. Accordingly, Foley and his bondsman are liable for any loss suffered by Fiumara by reason of claims provable under the Miller Act bond. We agree with the appellee that the mere existence of liability to Warren Corporation would not suffice, for the bond appears by its terms to provide only for indemnity against loss."

It is, therefore, submitted that these cases support Appellants' contentions in this case.

The cases cited adequately demonstrate that the function of the court in a case of this kind is to ascertain the intent of the parties with respect to whether or not materialmen and laborers were intended to be benefited.

V.

A Joint Judgment Against the Surety and Prime Contractor Is Erroneous.

This point is responsive to Appellee's point "C" commencing on page 19 of its brief. In citing Section 2777 of the Civil Code of the State of California in support of a joint judgment against Appellants, Appellee seems to be confused. The section is inapplicable to the principal, surety and obligee relationship. If the principal or surety is liable so is the other. This in no way affects the liability of the obligee. Appellant Grandy, Inc., is the obligee.

Appellee is further confused in asserting that E. F. Grandy, Inc., is a nominal appellant. Each of appellants assert that neither is liable and each asserts that if the other is liable it is not. Nothing could be more clear and the separate and adverse, although consistent, position of each appellant is easily perceived. The surety most certainly does not concede that it is liable at all, ultimately, or otherwise. In addition, the surety asserts that it is not liable until Grandy, Inc., suffers loss or damage. That is the contract.

Now, surely Appellee does not contend that the District Court of Appeal of the State of California, which decided the case of *Ramey v. Hopkins,* 138 Cal. 685, 33 P. 2d 433, in 1936, or the United States Circuit Court of Appeals which decided the case of *United States v. U. S. F. & G. Co.,* 113 F. 2d 888, in 1940, are courts of "the early days of the common law." Both of these cases support Appellant's contentions and were cited in the opening brief.

The language of California Civil Code, Section 2777, is easy to understand, but the language of *Fidelity & Deposit Company of Maryland v. Pittman* (1936), 52 Ga. App. 394, 183 S. E. 572, quoted in italics added by Appellee on page 21 of its brief, is exceptionally clear.

> "The subcontractor's bond is a joint and several obligation of the subcontractor and the surety."

We have been pointing out that Appellee sued the *prime contractor,* not the subcontractor. Grandy, Inc., is the *prime contractor* and the *obligee.* There is no principle even suggested by Appellee as to how the *prime contractor obligee* could possibly be liable jointly with the subcontractor's surety.

As a part of the point under discussion Appellee propounded two questions at page 21 of its brief, the answers to which appear in Appellants' opening brief at page 26 and have so often since been mentioned that further discussion would be an imposition. The reasons which Appellee assigns for the Payment Bond are imaginative and unreal and unsupported by the record. So also is the assertion that Grandy, Inc., covenanted with the Government to pay for all materials furnished.

Completely detached in reason and logic is the statement next following that persons who supply materials and labor to Grandy, Inc., may sue Grandy, Inc., therefor. Appellee forgets that it furnished materials and labor to V. L. Murphy, the subcontractor, and not to Grandy, Inc. California Civil Code, Section 1559, and *W. P. Fuller & Co. v. Alturas School District* (1915), 28 Cal. App. 609, 163 Pac. 743, cited by Appellee under this point, refers to third party beneficiary contracts and are so far out of context respecting the problem of joint liability of Appellants as to be meaningless.

VI.

No Contractual Relationship Between Appellants and Appellee Is Alleged or Proved.

This point is responsive to point "D" of Appellee's brief commencing on page 22 thereof. The quotation of paragraph VI of the Complaint exemplifies Appellants' contention that there are no allegations of a contractual relationship in the Complaint. Appellee is correct in stating that the Complaint need only allege the ultimate facts of contractual relationship, but these are conspicuous by their absence. Appellee points to neither evidence nor findings to meet the objections raised by Appellants.

Never before has it been suggested that it is the implied in-law duty of a prime contractor to either pay the materialmen of his independent subcontractor, or furnish a bond to guarantee such payment. Likewise, the concept that the recipient of a purchase order makes an offer thereby is new to the law. No comment is required.

Appellee asserts that the finding that there is a contract implies an offer and acceptance and hence no more particular finding is necessary. We wish to point out that this depends upon whether the contract found is express or implied. Appellants are at least entitled to this information in the findings. It also begs the question to say that consideration appears from the fact that the material was furnished. Appellants are entitled to a finding as to whom the goods were furnished, which would disclose that they went to V. L. Murphy, not to either Appellant. In the same category is the assertion that it was unnecessary to find that Grandy, Inc., requested the materials since it was delivered to the job for which Grandy, Inc., was the prime contractor. These assertions of Appellee

emphasize the contention of Appellants that the findings are vague, uncertain and insufficient.

But of all, the most startling statement appears upon page 26 of Appellee's brief. It is refuted by simple repetition:

> "There is always an implied agreement to pay for goods *furnished to another* for the purpose of completing a contract for which he (the contractor) expects to be paid." (Italics ours.)

The *Pacific States* case is not authority for this proposition nor does any exist.

Conclusion.

Appellee concedes an error in computation of interest (see its brief, page 27) and in the amount of the judgment, since on page 25 it concedes that the contract price was the reasonable worth and value of the materials, to wit: $6,124.37. Appellants further believe that other errors have been disclosed which present no alternative to reversal with instructions to enter judgment for Appellants.

Respectfully submitted,

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